BELGIAN 2018 CORPORATE TAX REFORM ACT PUBLISHED TODAY – WHAT'S THE IMPACT FOR OUR CLIENTS' BUSINESSES?

The long-awaited 2018 Belgian corporate tax reform has been voted and was published earlier today in the Belgian State Gazette. We have briefly summarised the most important of the newly-adopted measures and the impact they will have on our clients' business. Most of these measures had been expected as they are in line with the initial government proposals (which we outlined in our client briefing of August 2017).

Some of the new measures will apply as of 2018 (i.e. financial years starting on or after 1 January 2018) while other important new rules will only apply as of 2019 or 2020 onwards.

Please note that the vote on some important parts of the 2018 tax reform, which are outside the sphere of corporate income tax, has been delayed and is expected in the first quarter of 2018. This includes the heavily debated tax on securities accounts.

Gradual reduction of corporate income tax rates in 2018 and 2020

As anticipated, the standard corporate income tax rate of 33.99% will be lowered to 29.58% in 2018, and to 25% as from 2020. Subject to certain conditions, small and medium sized enterprises (SMEs) will benefit from a special reduced rate of 20% on the first EUR 100,000 of taxable profits.

It is important to note for our real estate clients that the so-called exit tax rate on conversions in/transactions with a BE-REIT or a Belgian SREIF, which was previously set at half of the applicable corporate income tax rate, will immediately reduce to 12.75% as from 2018, but will increase to 15% as from 2020 onwards.

For the pricing of a real estate share deal (the latent capital gains tax discount component), it will be important to consider the impact of the gradual reduction of the standard corporate income tax rates, as well as the future increase of the exit tax rate for those purchasers considering a conversion into a SREIF.

But with important compensatory measures increasing the taxable base

Minimum taxable base for large companies with excess tax deductions

As from 2018, a minimum taxable base will apply for large companies benefitting from substantial (historic) tax deductions: the annual profits exceeding EUR 1 million can only be offset up to 70% with these available (historic) tax deductions, while the remaining 30% of profits will constitute a minimum taxable base, fully taxable at the above-mentioned new rates.

Tax deductions that cannot be used in a given year as a result of this new rule can, in most cases, be rolled over to the next financial year(s). Tax deductions in such cases are not lost (which is important for listed companies with IFRS accounts that book these deductions as a deferred tax asset), but the benefit of the deductions is spread over time, and the net present value of the tax benefits is therefore lower.

The deductions concerned are the tax losses carried forward (TLCF), the dividends received deduction carried forward (DRDCF), the innovation income deduction carried forward (IIDCF) and the annual as well as the carried forward notional interest deduction (NIDCF). Deductions for investments (general and innovation) are not limited by the new rule. The order in which these deductions are applied has been slightly changed as well, in order to avoid (to the extent possible) a negative impact on, for example, effective use of the annual NID (which, if limited under the new rule, would in principle be lost forever).

Let's take an easy example: a company with tax losses carried forward (TLCF) of 1 million and notional interest deduction (NID) of 1 million, with an annual profit before tax of 2 million, would not pay taxes under the current rules. Under the new rules, 300k (i.e. 30% of its profits above 1 million) would be subject to tax, but the company would be able to rollover the 300k of 'unused' tax losses to the next financial year.

It should be noted that the new limitation also applies to companies selling off all their assets or liquidating (including a situation in which a real estate company converts in or reorganises with a BE-REIT or SREIF), which seems somewhat unreasonable considering that in those cases the limitation *de facto* means a definitive loss of the tax deductions.

The companies which will be hit hardest by this new measure are obviously those sitting on large stocks of historic tax deductions which had expected not to be in a taxable position for a number of years (such as banks, real estate companies with historic vacancy issues and technology start-ups). Insofar as this applies to start-ups, it should be noted that there is a 4-year grace period for newly incorporated SMEs.

The impact of this new rule should also be carefully considered in a transactional context, especially if the benefit of existing historic tax deductions is being priced or otherwise taken into account in the purchaser's business model.

It is also important to note another new rule here that will, in certain cases, prevent taxpayers from using tax losses (and other tax deductions carried forward) to off-set tax increases imposed following a tax audit. Here again, there is an effective cash out for the company notwithstanding the availability of sufficient tax deductions carried forward, but with the possibility to rollover the unused tax deductions to the next financial year(s). When negotiating warranties and indemnities in the context of a share deal the impact of this new rule will need to be carefully considered.

Capital gains on shares to become fully tax exempt but subject to minimum participation conditions

The currently applicable 0.412% share capital gains taxation will be abolished as from 2018. However, the exemption will now be subject to the minimum participation thresholds that already apply for the dividend taxation exemption ('DBI'/'RDT').

The introduction of these minimum participation thresholds will substantially increase the tax burden for smaller portfolio companies, carried interest structures and other management participation schemes structured through a personal management company.

As a result, a Belgian company holding shares not representing at least 10% of the subsidiary's capital or with an acquisition value of at least EUR 2.5 million will become fully taxable on the capital gains it realises on a sale of these shares, at the standard rate of 29.58%, whereas today the maximum taxation is 0.412%, or 25.5% in the case of a short-term capital gain.

The introduction of these minimum participation thresholds will substantially increase the tax burden for smaller portfolio companies, carried interest structures and other management participation schemes structured through a personal management company. An alternative would be to hold smaller participations privately (i.e. not through a company structure), but the impact of possible reforms to individual taxation in the future should be carefully considered. Another alternative would be for companies to hold smaller participations through a Private Pricaf, or a so-called SICAV-RDT, for which (subject to certain conditions) the minimum participation thresholds would not apply.

Notional interest deduction downscaled

The benefit of the notional interest deduction (NID) has been substantially reduced: as from 2018 the deduction percentage will only be calculated on the equity increase as measured over a 5-year period. Companies with a decreasing equity position will lose all NID entitlement. Companies with an increasing equity position will continue to benefit from the NID but only on the net increase, and the impact of the equity increase will be spread over 5 years (the annual NID basis will be 1/5th of the net increase). For newly incorporated companies, the NID basis for the first 4 years will be equal to 1/5th of the relevant year's equity position.

For example, a company with a qualifying equity of 2 million in Y1-5 and 1.9 million in Y6 (e.g. as a result of a 100k dividend distribution) would, under the current rules, still have NID in Y6 calculated on 1.9 million. However, under the new rules, it would fully lose its NID entitlement. If the equity would have increased to 2.5 million in Y6, the company would have NID in Y6 calculated on 100k (i.e. 500/5). Note that the way the net equity increase is calculated (i.e. by comparing the equity position of Y6 with Y1, rather than comparing it with the average equity position over Y1-5), could have a perverse effect during the first years, as recent equity increases could lead to a higher NID entitlement than equity increases which took place longer ago.

As recently suggested by the National Bank of Belgium, the downscaling of the NID will mean that in practice many of the intragroup banks and treasury centres located in Belgium may suddenly lose all NID entitlement, as many of them have indeed reduced their equity positions over the past few years in reaction to the reduced NID rate and the ongoing political debate on the future of the system.

Capital reductions partially treated as dividend distributions

The rules applicable to capital reductions are also changing and will provide for a proportional allocation of the capital decrease on the existing taxed and certain untaxed reserves of the company.

Companies with substantial reserves that decide to reduce their capital may therefore, as from 2018, be confronted with significant tax leakages.

Under the current rules, a capital reduction does not give rise to Belgian withholding tax. For shareholders not benefitting from a withholding tax exemption or full tax credit (mainly private individuals and certain categories of foreign shareholders), an upstream of proceeds via a capital reduction rather than via a dividend distribution was, therefore, generally beneficial.

As from 2018, a capital reduction will be deemed to derive proportionally from (i) the paid-up capital, (ii) the taxed reserves (incorporated and non-incorporated into capital), and (iii) the untaxed reserves incorporated into the capital of the company. The part of the capital reduction that is deemed to derive from the taxed and untaxed reserves will be treated as a dividend from a tax perspective and be subject to withholding tax if applicable. The part deriving from the untaxed reserves may additionally give rise to a corporate income tax charge at the level of the distributing company. The same rules apply to repayments of share premium and repayments of amounts subscribed in exchange for the issuance of profit certificates.

The so-called legal reserves, the untaxed reserves not incorporated into the capital and certain specific untaxed reserves originating from previous merger or demerger transactions all fall outside the proportional allocation rule. In addition, within the proportional allocation of the reserves, the untaxed reserves which fall under the allocation rule are only to be distributed if there are insufficient taxed reserves.

Let's take an easy example. A company with a paid-up capital of 100, taxed reserves of 40, untaxed reserves of 50 (not affected by the new rule) and untaxed reserves incorporated in the capital of 60 (affected by the new rule), reduces it capital by 100. 50 will constitute a capital reduction, 40 a distribution of taxed reserves and the remaining 10 a distribution of untaxed reserves. As outlined above, in addition to a possible withholding tax on 50, the 10 distribution of untaxed reserves may give rise to a corporate income tax charge at the level of the distributing company.

New interest deduction limitation rule

As from 2020, an important new limitation on the deductibility of interest will apply: the 'net borrowing cost' of a company will only be deductible up to 30% of the corrected EBITDA of the company. The new limitation will replace the currently applicable 5:1 debt to equity restriction applicable to related party debts and will apply to all indebtedness (including bank debts).

There is a minimum safe harbour of EUR 3 million of interest per year, i.e. the maximum annual interest deduction will be either (i) 3 million or (ii) 30% of the corrected EBITDA, whichever is higher. However, the 3 million safe harbour can only be applied once for an entire Belgian group of companies and will need to be apportioned between the different Belgian group companies or branches. Regulations on how the apportionment will operate and other specific rules for Belgian groups still remain to be issued.

Interest expenses which are not deductible as a result of the new 30% limitation can be carried forward and used to offset future profits, but always within the same 30%/3 million limit. In other words, a company that exceeds the thresholds every consecutive year will never be able to effectively use the carried forward excess interest deductions.

As there is currently no general limitation in Belgium on the deductibility of interest on external (bank) loans, the new 30% rule will be a game changer, particularly for large Belgian companies or groups with annual interest expenses exceeding EUR 3 million.

The exact scope of 'borrowing costs' for the purposes of the new 30% limitation still remains to be specified by a Royal Decree but will go beyond the classical tax definition of interest to include also the finance cost element under a financial lease, payments under hedging agreements, FX gains and losses, and guarantee and arrangement fees. Only the net borrowing cost is limited, i.e. after netting with the interest income. The corrected EBITDA is the net income before interest, taxes, depreciations and write-offs, reduced by the tax exempt part of the income and certain other specific items.

Loans concluded before 17 June 2016 are grandfathered (but remain fully subject to the existing 5:1 debt to equity restrictions) and loans concluded in the context of EU-based public-private partnerships (PPPs) are excluded. Stand-alone entities and certain categories of financial institutions and undertakings (including banks, insurance companies, UCITs and AIFs) are exempt from the new rule.

As there is currently no general limitation in Belgium on the deductibility of interest on external (bank) loans, the new 30% rule will be a game changer, particularly for large Belgian companies or groups with annual interest expenses exceeding EUR 3 million. On the other hand, this 30% rule is the implementation of the European ATAD (Ant Tax Avoidance Directive) which will need to be implemented by all the other EU member states as well, so there will be a level playing field across the different EU countries.

For real estate clients, certain important questions remain open, for example the fact that, based on the current texts, BE-REITs are not excluded from the limitation (SREIFs are as they qualify as AIF) and issuers of real estate certificates do not seem to be excluded either.

The introduction of tax consolidation 'light'

Belgium will, after many years, finally have a tax consolidation system, albeit in a 'light' form. Belgian tax consolidation will apply as from 2019, and will allow a qualifying Belgian group company to offset its profits against excess current year tax deductions of another qualifying Belgian group company.

The introduction of a Belgian tax consolidation regime is very good news for Belgian groups which are profitable but with excess tax deductions in certain parts of the group. It will also, to some extent, facilitate the structuring of leveraged buy-outs.

Tax consolidation will only be possible between 90% related Belgian companies or branches (i.e. between parents and subsidiaries, provided the parent holds a participation of at least 90% in the subsidiary, or between sister companies having a 90% joint parent) and provided this participation has been held for an uninterrupted period of at least 5 years.

Only current year tax deductions can be used to compensate taxable income. Tax consolidation cannot give rise to a transfer of tax losses from previous years.

There is no consolidated tax return and each Belgian company will continue to file its own tax return. The group companies concerned will have to enter into an 'intra-group transfer agreement' at the end of each relevant taxable period and the group company benefitting from the transferred tax deductions will need to pay compensation to the transferring company equal to the tax savings realised (such compensation payment being treated in a fully tax neutral way for both companies).

The introduction of a Belgian tax consolidation regime is very good news for Belgian groups which are profitable but with excess tax deductions in certain parts of the group. It will also, to some extent, facilitate the structuring of leveraged buy-outs. Interest expenses at the level of the Belgian acquisition vehicle (bidco) can now be offset with the operational income at the level of the Belgian target company (after a 5-year waiting period), and will therefore reduce the tax incentive for post-acquisition debt push-downs (which have recently come under increased scrutiny from the tax authorities). However, some important new limitations will apply, and the impact of these will have to be carefully analysed: the 5-year 'waiting' period for the tax consolidation with a new target (which is a long time in the context of a leveraged buy-out), the 30% interest limitation and the 3 million safe harbour at Belgian group level and, in the same context, the exclusion of exempt dividend and capital gains tax income from the corrected EBITDA.

Increased attractiveness of Belgian holding company regimes

Tax consolidation will make the use of Belgian acquisition vehicles and central holdings more attractive than before. In addition, the re-introduction of a full share capital gains tax exemption and, even more importantly, the increase of the participation exemption from 95% to 100% as from 2018 will be an important boost for Belgium as holding company jurisdiction. The new 30% interest deduction limitation may have a negative impact, but this is an EU rule and as such a level playing field can be expected across the different EU member states.

Certain Belgian based groups which have moved some of their international holding functions outside of Belgium should seriously consider migrating these holdings back to Belgium, also considering BEPS and the increased focus on local substance.

The anticipated changes to the Private Pricaf (*'private pricaf'/'pricaf privée'*) regime are also worth mentioning. This is a tax exempt fund structure dedicated to private equity investments which is suitable for both qualified individual and institutional investors. The Private Pricaf regime's success has been limited until now, mainly due to a regulatory prohibition on the Private Pricaf taking controlling participations in target companies (subject to certain strict exceptions). This restriction should soon be released, together with some other changes aimed at increasing the flexibility of the vehicle. From a tax perspective, the tax reform act explicitly stipulates that the minimum participation thresholds (and the one-year minimum holding period) for the application of the dividends and capital gains tax exemption do not apply, neither at the level of the Private Pricaf nor at the level of its shareholders. This is an important advantage for Private Pricafs, especially considering the introduction of the minimum threshold conditions for the capital gains tax exemption for ordinary companies.

A final note also on the anticipated Belgian company law reform. The Belgian government is in the process of revising the Belgian Company Code which might impact certain corporate transactions and restrictions such as the dividend distribution rules (which would no longer refer to the availability of distributable reserves, but to a liquidity and solvency test comparable to the existing Dutch BV rules) and the financial assistance rules (although in the latest available proposals the existing Belgian financial assistance rules do not seem to have been relaxed).

Other new tax rules worth mentioning

- Further to the implementation of the European ATA Directive, Belgium is also introducing specific so-called 'CFC' rules. The impact of these rules is to immediately tax profits realised by low-taxed foreign subsidiaries that are engaged in 'non-genuine arrangements' (i.e. holding assets for which all important/strategic decisions and the risks are taken/managed by the Belgian shareholder). The profit of such subsidiaries will be immediately taxed at the level of the Belgian shareholders in Belgium), without the need for these profits to be effectively distributed. In addition, further exit tax provisions for cross-border transfers of assets are introduced and the concept of 'Belgian establishment' is extended.
- A new low taxed profit participation premium regime for employees is introduced.
- The double declining balance amortisation method (*degressieve afschrijvingen – amortissements dégressifs*) will be abolished for assets acquired or established after 1 January 2020. There will be more stringent rules on the deduction of provisions for risks and charges (e.g. it will no longer be possible to record general provisions for possible repair and maintenance) and the so-called 'matching principle' will need to be adhered to (i.e. expenses paid in a given year, but which relate to income or operations of subsequent years, will need to be spread over the years concerned).
- All penalties imposed by public authorities will become fully non-tax deductible, including proportional VAT penalties.
- The late payment interest system is amended. As from 2018, late payment interest will no longer be fixed at 7%, but will be linked to the evolution of the OLO interest rate, and will range between 4% and 10% for interest due to the Treasury. Late payment interest due by the Treasury will always be 2% lower and range between 2% and 8%.

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