

PRACTICAL EUROPEAN TAX STRATEGIES

Werner Heyvaert (wheyvaert@jonesday.com) is Of Counsel with Jones Day, Brussels. His practice is focused on the tax aspects of domestic and international transactions, including structured and cross-border financings, mergers and acquisitions, transfer pricing, VAT and tax litigation.

Belgium Amends Its Notional Interest Deduction Regime to Comply with *Argenta Spaarbank* Case—Impact of the ECJ’s Ruling in the *K* Case

By Werner Heyvaert

The ECJ’s decision in the *Argenta Spaarbank* case has significant implications for the calculation of notional interest deduction by Belgian companies with permanent establishments or real estate outside Belgium. The following article reviews the decision, the legislative response, the first commentaries from the Belgian Tax Authority and an ECJ case that has certain similarities with the *Argenta Spaarbank* conundrum.

I. Introduction

Effective January 1, 2006, Belgium enacted an innovative tax incentive to stimulate Belgian companies as well as Belgian branches of non-resident companies to accumulate more equity and rely less on debt to finance their investments and business activities.¹ The new tax incentive was nicknamed the “Notional Interest Deduction” (NID). Basically, it entails the allowance of a deduction for a fictitious interest payment computed on the adjusted equity of the company or branch as a form of tax-deductible return on that equity. The percentage rate of this fictitious interest or return on equity is determined year by year, linked to the interest rate for 10-year Belgian treasury bonds. For example, for calendar year 2014, the NID rate will amount to 2.630 percent of the adjusted equity (3.130 percent for Small or Medium-sized Enterprises—SMEs).

Since its creation in 2005, several amendments and adjustments were made to the NID regime, chiefly to contain (for which, read “curtail”) the adverse budgetary

impact of the incentive. For example, it was reported that for 2011, a total amount of €6.16 billion was deducted by way of NID by all Belgian corporate taxpayers. At a nominal corporate tax rate of 33.99 percent, that deduction represented a tax cost of approximately €2 billion, which must be compared with the total revenue raised in the form of corporate income tax for that same period, being just short of €9.3 billion. In other words, the NID regime reduced the revenue generated by the entire corporate income tax system by approximately 18 percent.

To combat certain perceived abuses, a Belgian corporate taxpayer’s equity is adjusted for purposes of computing the NID. It would go beyond the scope of this article to describe all of these adjustments in detail, but two examples will clarify the nature of those adjustments for the international reader, and are especially relevant in the context of recent EU jurisprudence.

First, pursuant to the Belgian participation exemption regime, dividends from qualifying shareholdings are 95 percent exempt in the hands of Belgian corporate shareholders (e.g., holding companies) in order to mitigate double taxation of corporate profits (once at the level of the operating company and once at the level of the holding company). Because such shareholdings generate almost no corporate income tax at the level of the holding company—only 5 percent of the dividends are taxed at 33.99 percent, i.e., an effective rate of tax of less than 1.7 percent—the book value of these shareholdings must be deducted from the holding company’s equity for purposes of computing



its NID.

A second such adjustment to equity, until recently, involved eliminating the amount of the net book value of a branch of a Belgian company situated in a country with which Belgium has a bilateral tax treaty, providing for an exemption of branch profits in Belgium. The rationale for this adjustment was that when a Belgian company has a branch located in a treaty country, such a branch does not generate taxable income in Belgium because all of Belgium's bilateral tax treaties by and large exempt branch profits from Belgian corporate income tax at the level of the Belgian head office.² Here, too, the underlying rationale for the exemption of foreign branch profits is the avoidance of double taxation, i.e., once in the branch country and once in Belgium. Thus, as branch profits do not contribute to the Belgian tax base of such a corporate taxpayer, the legislator deemed it appropriate to exclude the net book value of such foreign branches from the computation of the NID base. The same principle applied to real estate located in treaty countries.

II. *Argenta Spaarbank* Case

In 2008, *Argenta Spaarbank NV*—a Belgian savings bank operating a branch in The Netherlands—challenged the validity of the above-described exclusion of the net book value of its Dutch branch from the computation basis of its NID. The principal argument of *Argenta* before the tax court in Antwerp was that the exclusion of the equity of its Dutch branch falls afoul of the principle of freedom of establishment as laid down in Article 49 of the Treaty on the Functioning of the European Union (TFEU). The reasoning was that if *Argenta* had operated its branch in Belgium, the net assets would have been allowed for purposes of computing its 2008 NID amount, whereas those very same net assets were being disallowed in this case because they were connected with a branch located in another EU Member State (*viz.*, The Netherlands). *Argenta* contended that by making it more attractive from a corporate tax point of view to keep the assets in Belgium rather than investing them in or through a Dutch branch, Belgium infringed the freedom of establishment.

Argenta contended that Belgium's national tax law was not compliant with EU law. Because under appropriate circumstances, EU law supersedes national law, on June 24, 2011, the Antwerp tax court submitted the issue to the EU Court of Justice (ECJ) in Luxembourg for a preliminary ruling on the subject. Following the opinion previously issued by Advocate-General Mengozzi, the ECJ held on July 4, 2013, in favor of *Argenta* and found that Belgium's NID regime was a hindrance to the freedom of establishment insofar as it disallowed assets invested by a Belgian company through a Dutch branch from the basis for computing the NID.³

Needless to say, with the ECJ ruling in hand, every taxpayer finding itself in the same or a similar fact pattern was able to claim the NID on the value of any assets invested in or through a branch located in any EU Member

State. But this posed a serious threat for the Belgian treasury because it opens the door for Belgian corporations to invest equity in low-taxed EU Member States⁴ and by doing so reduce yet further their remaining tax burden on their Belgian income while keeping those branch profits out of the ambit of the Belgian Tax Authority pursuant to applicable tax treaty provisions. Not surprisingly, the

If an EEA Branch would end the fiscal year with a net loss, the proportion of NID corresponding to the assets of the Branch can be deducted from the company's other profits (i.e., Belgian-source profits).

Belgian Government was quick to act and fix the NID regime so as to bring it in line with EU law and the freedom of establishment principle as enunciated by the *Argenta Spaarbank* decision.

III. Law of December 21, 2013

With the introduction of Article 7 of the Law of December 21, 2013 (Law), the Belgian Government has purported to remedy the lack of compliance of the NID regime with EU law. In essence, the Law repealed the provision of the NID regime that disallowed assets allocated to a branch situated in a treaty country.⁵ By the same token, Article 8 of the Law reduces the NID for Belgian companies that operate through a branch in a treaty country that is a member of the EEA.⁶ Henceforth, the total amount of NID computed in accordance with Article 7 of the Law, will be reduced as follows:

- if the Belgian company has invested any assets in or through a branch located in a treaty country that is not a member of the EEA, the total amount of NID will be reduced by the proportionate part thereof that corresponds to the net assets invested in such branch;⁷
- if the Belgian company has invested any assets in or through a branch located in a treaty country that is a member of the EEA (EEA Branch), the total amount of NID will be reduced by the proportion thereof that corresponds to the net assets invested in the EEA Branch,⁸ but only insofar as the total amount of NID exceeds the business profits derived from the EEA Branch. In other words, if an EEA Branch would end the fiscal year with a net loss, the proportion of NID corresponding to the assets of that EEA Branch would not be forfeited but can, instead, be deducted from the company's other profits (i.e., Belgian-source profits).

These new rules entered into effect for tax assessment year 2014 (i.e., for book years ending on or after December 31, 2013).

IV. Circular Letter No. 19/2014 of May 16, 2014

On May 16, 2014, the Belgian Tax Authority published its first comments to the Law in a brief circular letter (No. 19/2014, Ci.RH.421/629.195) (Circular) on its web site. The Circular describes very briefly what the ECJ has ruled in the *Argenta* case and then outlines to its officials and concerned taxpayers that for past tax years, an administrative appeal can be filed within the regular time period (statute of limitation) of six months following the assessment note⁹ (to the extent it does not comply with the outcome of the *Argenta* case) or an application for relief *ex*

The consequences of the ECJ's position in the *Argenta* case cannot be underestimated.

officio can be filed in accordance with the normal rules,¹⁰ until five years following January 1 of the year in which the tax has been assessed (to the extent such assessment did not comply with the outcome of the *Argenta* case). The ruling in the *Argenta* case can, for these purposes, be considered as a “new fact,” something that is required in order to validly apply for relief *ex officio*.

V. Impact of the K Case

On November 7, 2013 the ECJ handed down its ruling in the *K* Case.¹¹ Mister K was a fully taxable resident taxpayer in Finland who had suffered a capital loss upon the sale of immovable property situated in France. K wanted to deduct the French capital loss from his fully taxable Finnish income—notably gains deriving from the sale of securities—because he did not have any other French-source income or gains to offset the French capital loss. Such cross-border loss deduction was denied by the Finnish tax authorities, following which Mr. K brought his case before the Turku Administrative Court, which sided with the Finnish tax authorities. Mr. K then brought his case before the Supreme Administrative Court in Finland contending that his freedom of establishment and free movement of capital rights would be infringed if he were denied the right to offset his French real estate capital loss against his Finnish securities capital gains. Mr. K contended that the allocation of the power to impose taxes between Member States could not justify the denial of any cross-border capital loss deduction. An important argument made by Mr. K was that the prevention of double deduction (of the French loss) was of no concern in his case, because he did not have other assets in France or other income from French sources, nor did he carry on business in France (meaning that he would not be able to offset the French real estate capital loss against any taxable French income or gain). After comparison of the fact pattern at hand with the facts of *Lidl Belgium* and *Krankenheim Ruhesitz am Wannsee-Seniorenheimstatt* (two ECJ cases of 2008), the Supreme Administrative Court decided to stay the proceedings and refer to matter to the ECJ for a

preliminary ruling. The actual question submitted to the ECJ is to know whether or not Finland can preclude a Finnish-resident taxpayer from deducting a capital loss resulting from the sale of French real estate from gains on securities that are fully taxable in Finland, while Finnish tax law would have allowed the deduction of a capital loss resulting from the sale of Finnish real estate from the same capital gains.

After having confirmed that the non-deductibility of the French real estate capital loss objectively constitutes a restriction of Mr. K's right to free movement of capital, which is prohibited by virtue of Article 63 TFEU, the ECJ then investigated whether or not a valid justification would exist. The Finnish and the German governments argued that because capital gains deriving from French real estate are taxable only in France (on the basis of the French-Finnish bilateral tax treaty), the position of a Finnish taxpayer investing in French real estate was different from (not comparable with) the position of the same taxpayer investing in Finnish real estate. Based on such different tax positions, the different treatment of capital losses would be justified, according to Finland and Germany. The EU Commission had taken the position that Mr. K's position was different from that of a Finnish taxpayer who had invested in Finnish real estate because in Mr. K's position, the capital loss was not tax-deductible in France due to French national law and the provisions of the French-Finnish bilateral tax treaty; the ECJ turned that argument down stating that the different treatment in France cannot lead to a justification for Finland to restrict the fundamental freedoms of its residents by disallowing the capital loss for Finnish tax purposes. The ECJ concluded that “*the different tax treatment, so far as concerns the possibility of deducting losses sustained on the sale of immovable property, cannot be justified by a difference in situation related to the place where the property concerned is situated.*” (r.o. 48.)

Then the ECJ investigated “*whether the restriction at issue ... may be justified by overriding reasons in the public interest.*” (r.o. 49.) It would go beyond the scope of the present article to go in detail into each of the four potential grounds for justification of the contested restriction on the basis of overriding reasons in the public interest. However, we want to briefly highlight the two grounds of justification that were admissible in the eyes of the ECJ.

The first admissible ground of justification is—in the parlance of the ECJ—the balanced allocation of the power to impose taxes between Member States.

The ECJ referred to its findings in *Lidl Belgium* and *Philips Electronics UK*, where it stated that this justification “*is designed, inter alia, to safeguard the symmetry between the right to tax profits and the right to deduct losses.*” (r.o. 51.) The ECJ states that “[i]f it were accepted that losses incurred on the sale of immovable property situated in [France] must be deductible in the Member State in which the taxpayer resides [Finland], regardless of the allocation of taxing powers agreed between the Member States, that would effectively allow the

taxpayer to choose freely the Member State in which the taking into account of those losses is most advantageous from the tax perspective ...". (r.o. 54.) Referring to r.o. 40 of the Opinion of the Advocate General, the ECJ finds that "the refusal to allow deduction of losses arising from the sale of immovable property situated in France permits the symmetry between the right to tax profits and the right to deduct losses to be safeguarded. The measure also contributes to the objective of ensuring a balanced allocation of the power to impose taxes between Member States." (r.o. 55.)

The second admissible ground of justification is—again in the parlance of the ECJ—the cohesion of the tax system.

The ECJ stated that "... if the France-Finland Convention were to be disregarded, the Republic of Finland would have the right to tax the gains made by a taxpayer residing in Finland from the sale of property situated in France. However, the result of applying the France-Finland Convention in conjunction with the Finnish tax legislation is that gains deriving from the transfer of immovable property situated in France escape all form of taxation in Finland, as they are neither taxed nor otherwise taken into account there. That being so, in providing that a resident taxpayer who incurs a loss on the sale of a property situated in France cannot make us that loss in Finland, the Finnish system reflects a logic of symmetry [...]. ... [A] direct link thus exists, in the case of the same taxpayer and the same tax, between, on the one hand, the tax advantage granted, namely the taking into account of the losses generated by a capital investment, and, on the other, the taxation of returns on that investment." (r.o. 67-69.)

Because the ECJ accepts those two grounds for justification, it arrived at the conclusion that the Finnish tax authorities and the Turku Administrative Court had legitimate reasons to refuse the deduction of Mr. K's French capital loss from his Finnish capital gains on securities because "Articles 63 TFEU and 65 TFEU do not preclude national [Finnish] tax legislation [...], which does not allow a taxpayer who resides in the Member State concerned [Finland] and is fully liable to income tax there to deduct the losses arising on the transfer of immovable property situated in another Member State [France] from the income from moveable assets which is taxable in the first Member State [Finland], although that would have been possible, on certain conditions, if the immovable property had been situated in the first Member State [Finland]."

The first Belgian commentaries¹² on the K Case rightfully point out that the ECJ's findings in the K Case would seem to support the way in which the Belgian legislature has remedied the NID rules following the *Argenta* case. Indeed, according to the ECJ's decision, tax advantages or adjustments can be limited to real estate located in the Member State granting the tax advantage (deduction of losses), provided that such limitation is necessary to safeguard the balanced allocation of the power to impose taxes between the Member States and to ensure the cohesion of the [Finnish] tax system and that it is appropriate for attaining those objectives. Because the new Belgian NID rules in fact do now achieve a similar

symmetry, it may be expected that they should stand the test of EU law going forward.

VI. Comments and Conclusion

When the opinion of Advocate-General Mengozzi was released on September 19, 2012,¹³ and even more so when the ECJ handed down its ruling in the *Argenta* case on July 4, 2013, many Belgian tax practitioners, as well as several academics,¹⁴ were taken by surprise. Based on the status of the ECJ's case law until then, it was believed that the Belgian NID regime was compliant with EU law insofar as the exclusion of assets invested in branches the income of which remained tax exempt in Belgium by virtue of a bilateral tax treaty appeared to be a legitimate exception to the NID regime. Indeed, it was felt that if Belgium were to allow foreign branch assets to be included in the computational basis for the NID, it should then legitimately be able to allocate the total amount of

Any proposal to deny the NID to corporate taxpayers that reduces their Belgian workforce while increasing their non-Belgian EEA workforce would likely be struck down by the ECJ.

NID so computed to that exempt income and, by doing so, reduce the amount of net foreign branch profits that Belgium must then exempt under the prevailing treaty. The end result would then be identical, or very close to the result achieved by simply excluding the foreign branch assets from the NID tax computation basis.

Hence, the consequences of the ECJ's position in the *Argenta* case cannot be underestimated: if an EU Member State introduces a tax incentive in its national tax legislation, it should be extremely cautious not to restrict the scope of such incentive by building in conditions that make a distinction between national versus foreign (EEA-connected) items. In its current state, the NID regime does not require any employment conditions to be satisfied by the taxpayer, but certain political parties in Belgium have already advocated the introduction of a more or less strict employment test (e.g., NID should be denied if the taxpayer reduces its workforce in any given year). The lesson to be learned from *Argenta* is that it would probably not be tolerated by the ECJ to restrict any employment condition to the Belgian territory. Thus, any proposal to deny the NID to corporate taxpayers that reduces their Belgian workforce while increasing their non-Belgian EEA workforce by the same or a higher number would likely be struck down by the ECJ.

One problem with the NID regime as originally enacted that certainly contributed to the outcome of the *Argenta* case was that the NID was not itself in any way connected to assets. It was (and still is) determined as a percentage

of the taxpayer's equity. Using foreign assets to reduce the computation basis of the NID was therefore difficult for the ECJ to accept. Had the NID been formulated as a percentage or otherwise computed as a fraction of the taxpayer's assets, the exclusion of non-Belgian assets might perhaps have been more acceptable to the ECJ (if the assets produce income that is tax exempt in Belgium, the NID relating to those assets could perhaps have been denied as well). To a certain extent, this is what the Law has done in order to remedy the "Argenta conundrum."

Finally, it remains to be seen whether or not the amendments made by Article 8 of the Law will withstand yet further scrutiny by the ECJ, if tested further. Indeed, for EEA branches, the "excess NID" is forfeited, while that would not be the case—in and of itself—for excess NID generated in a Belgian branch or business unit of the same taxpayer. Admittedly, since 2012, unused NID can no longer be carried forward further to a change in the Belgian NID legislation. But in our view that does not solve the problem. If a Belgian company has two business units (say, one in Antwerp and another in Brussels), any excess NID generated in one of these business units (for example, in Antwerp) can be utilized to reduce the corporate income tax liability of the other business unit (Brussels, in our example) without any territorial limitations. In this respect, the post-Argenta rules for EEA branches are still not as generous as those for domestic (Belgian) "branches." There may very well be yet more to come.

For a general overview of the Notional Interest Deduction regime as it was conceived in June 2005, see Werner Heyvaert & Dirk Deschrijver, *Belgium Stimulates Equity Financing*, Intertax,

Volume 33, Issue 10, 2005, 458-465.

²Reference might be made to Article 7(1) in conjunction with Article 23A of the OECD Model Tax Convention (2005).

³The English version of the *Argenta* ruling (Case No. C-350/11, July 4, 2013), together with a commentary by Mr. P. Wattel, are published in *Highlights and Insights on European Taxation* (H&I), 2013/140.

⁴E.g., the Republic of Ireland, where the standard corporate tax rate is only 12.5 percent.

⁵As well as real estate property located in a treaty country.

⁶Or that have real estate property located in a treaty country. The European Economic Area (EEA) consists of all EU Member States plus Norway, Iceland and Liechtenstein (i.e., three members of the European Free Trade Association or EFTA; although Switzerland is the fourth member of EFTA, it is not a member of the EEA).

⁷For purposes of this rule, the total amount of the NID will also be reduced by a proportion thereof corresponding to the net book value of any real estate located in such country.

⁸For purposes of this rule, the total amount of the NID will also be reduced by a proportion thereof corresponding to the net book value of any real estate located in such country.

⁹Articles 366 and 371 Income Tax Code 1992 (ITC92).

¹⁰Article 376, §1, ITC92.

¹¹Case C-322/11 (K), ruling from the ECJ dated November 7, 2013; conclusion from Advocate General P. Mengozzi of March 21, 2013. Both documents can be found on www.curia.europa.eu.

¹²Bart Peeters, *L'imputation transfrontalière de pertes et le droit européen*, *Fiscologie International*, Issue No. 360 (31.12.2013), pp. 6-8.

¹³<http://eur-lex.europa.eu>.

¹⁴See, for example, the comments of Dr. Mathieu Isenbaert in *Trends.be* of July 4, 2013, <http://trends.knack.be/economie/nieuws/beleid/europa-torpedeert-notionele-interestaftrek-wat-zijn-de-gevolgen/article-4000343021196.htm>. □