Bloomberg BNA

TAX MANAGEMENT INTERNATIONAL FORUM

Comparative Tax Law for the International Practitioner

VOLUME 34, NUMBER 4 >>> DECEMBER 2013

www.bna.com

Income Tax Withholding and Reporting Obligations on Cross-Border Payments

Facts and Questions

1. HCo is a Host Country corporation that is part of a multinational group of corporations. FCo, a Country X affiliate of HCo, seconds Exec, an individual Country X tax resident, to HCo to work in HCo's Host Country offices for the four-month period from September 1-December 31 of Year 1.
   - What are HCo's income tax withholding and reporting obligations to Host Country with respect to compensation it pays to Exec during this period?
   - Do those obligations differ depending on whether Host Country has an income tax treaty with Country X?

2. HCo's ultimate parent company, FHoldco, which is a tax resident of a country with which Host Country does not have an income tax treaty, licenses worldwide rights to certain valuable intellectual property to SisterCo, a tax resident of Country X, which has an income tax treaty with Host Country that exempts royalties paid to Country X residents from Host Country tax. Under the license agreement, SisterCo is obligated to pay FHoldco 95 percent of any royalties that SisterCo receives from sublicensing of the intellectual property. SisterCo in turn sublicenses the Host Country rights to the intellectual property to HCo for a royalty based on HCo's sales associated with such intellectual property.
   - What are HCo's income tax withholding and reporting obligations with respect to its payment of royalties to SisterCo with respect to the sublicense?
   - What are SisterCo's Host Country income tax withholding and reporting obligations — *if any* — with respect to any royalties it pays to FHoldco attributable to HCo's Host Country exploitation of the intellectual property?

3. HFund is a partnership organised and having offices in Host Country that is engaged in investing and trading in stocks and securities issued by Host Country corporations on behalf of its partners, who consist of investors some of whom are residents of Host Country and some of whom are residents of foreign countries. HFund borrows funds from Lender for a below-market fixed interest rate along with an "equity kicker" tied to HFund's performance. Lender is a partnership organised and managed from Country Z, a country with which Host Country does not have an income tax treaty, whose members consist of ten extremely wealthy individuals with prior business or social connections, three of whom are Host Country tax residents and the rest of whom are foreign (non-Country Z) tax residents. Lender is an investment partnership that makes strategic customised debt and equity investments throughout the world.
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THE TAX MANAGEMENT INTERNATIONAL FORUM is designed to present a comparative study of typical international tax law problems by FORUM members who are distinguished practitioners in major industrial countries. Their scholarly discussions focus on the operational questions posed by a fact pattern under the statutory and decisional laws of their respective FORUM country, with practical recommendations wherever appropriate.

THE TAX MANAGEMENT INTERNATIONAL FORUM is published quarterly by Bloomberg BNA, 38 Threadneedle Street, London, EC2R 8AY, England, Telephone: (+44) (0)20 7847 5801, Fax (+44) (0)20 7847 5858; Email: marketing@bna.com

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TM FORUM ISSN 0143-7941

Host Country BELGIUM

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I. Background

A. Withholding tax obligations

1. Withholding tax on interest, dividend and royalty payments

Income tax withholding on cross-border payments to nonresident individuals and foreign corporations is provided for in Article 261, 1° of the Belgian Corporate Income Tax Code ("BITC"), which imposes withholding tax on resident companies that make payments of income deriving from movable property and capital. Generally, disregarding any applicable exceptions and/or exemptions under Belgian domestic tax law and Belgium's network of tax treaties, the withholding tax rate applicable to dividend, interest and royalty payments to nonresidents is now 25 percent.[2]

Withholding tax is due upon payment or attribution of the income (interest, dividends or royalties, as the case may be) and must be reported and paid to the Belgian tax authorities within a 15-day period thereafter.[3] Despite the fact that Belgian tax laws do not allow the parties concerned to avoid their legal obligation to withhold tax, the parties can agree as to which of them will carry the ultimate burden.[4]

A number of withholding tax reductions and exemptions with regard to interest, dividend and royalty payments are available under Belgian domestic law and Belgium's various tax treaty provisions.

First, under the domestic law implementing the provisions of the EC Interest and Royalties Directive,[5] interest and royalty payments arising in Belgium are exempt from Belgian withholding tax provided that the recipient is an associated company of the paying company and is resident in another EU Member State or is a permanent establishment ("PE") of such a company that is also situated in another Member State. Two companies are regarded as being "associated companies" if: (1) one of them directly holds at least 25 percent of the capital of the other; or (2) a third EU company directly holds at least 25 percent of the capital of both of them (i.e., the two key corporate counterparties).[6] A continuous minimum holding period of one year is required.

Second, by adopting a Royal Decree in 2006[7] implementing the EC Parent-Subsidiary Tax Directive,[8] Belgium introduced a withholding tax exemption with respect to dividend payments to: (1) companies resident in another EU Member State; and (2) companies resident in non-EU Member States (such as the United States and Japan) that have concluded a tax treaty with Belgium containing an exchange of information clause sufficient to allow for the execution of the domestic tax laws of both States.[9] In order for companies to benefit from this, still relatively new and broad, zero withholding tax regime, a number of criteria must be met, however.[10] For instance, the dividends must relate to a participation of at least 10 percent in the capital of the distributing company.

Furthermore, as most of Belgium's tax treaties follow the OECD Model Convention, withholding tax reductions and/or exemptions with respect to interest, dividend and royalty payments are provided in many if not most of these treaties.[11]

In addition, domestic law provides for a variety of highly specific withholding tax exemptions regarding interest and royalty payments (which are irrelevant to the fact pattern at issue).

2. Withholding tax on professional income

Belgium grants employers the right to withhold tax from the compensation paid to employees.[12] In fact, the relevant provision indicates that it is the choice of employers either to carry the cost of the tax themselves, or to withhold the tax from the taxable income of employees. In either case, the employer has the responsibility to pay over the required tax to the tax administration.

Belgium's primary basis for imposing professional income withholding tax on nonresident employees can be found in Article 270 of the BITC, which states that professional income withholding tax is owed by: (1) Belgian residents (for tax purposes) that pay or attribute wages (*bezoldigingen/rémunérations*) in Belgium or abroad; and (2) nonresidents that pay wages in Belgium or abroad, to the extent that such wages constitute professional costs that are deductible from taxable income in Belgium.[13] The latter covers situations where nonresidents attribute such costs to a Belgian PE (and hence take a tax deduction by reason of such costs)), in which case withholding tax will be due. The tax is owed upon the payment or attribution of taxable wages.[14]

If the provision above is triggered, a nonresident employee may still qualify for an exemption from withholding tax on his/her professional income, pursuant to an applicable tax treaty.[15] Belgium's tax treaties determine (generally in Article 15) when, and under what conditions, income paid to a nonresident employee can only be taxed in the State where the employee has his or her residence. The treaties generally state that income earned by a resident of Country X, for work performed in Country Y, is taxable only in Country X, if:

- the Country X resident performs work in Country Y for no more than 183 days in any 12-month period commencing or ending in the fiscal year concerned; and
- the remuneration is paid by, or on behalf of, an employer that is not a Country Y tax resident; and
- the remuneration is not borne by a PE that the employer has in Country Y.

B. Withholding tax reporting obligations

1. Reporting obligations regarding dividend, interest and royalty payments

Withholding tax is due upon the payment or attribution of the income concerned[16] and, within a 15-day period thereafter, the debtor must file a withholding tax declaration with the Belgian tax authorities.[17] Specific declaration forms are available, the appropriate form depending on the type of payment at issue, i.e., dividends (Form 273A), royalties deriving from copyrights or related rights (Form 273S) and other payments (Form 273).[18]

These declarations must also reflect any amounts not subject to withholding tax, due to withholding tax reductions and/or exemptions, in which case the payor/withholding agent must add sufficient proof to support this position.[19] If the income in question qualifies for a reduction or exemption pursuant to a tax treaty concluded by Belgium, the debtor will have to complete and attach to its withholding tax declaration an additional Annex (*Bijlage/Annexe*) indicating that all conditions for the reduction/exemption are satisfied (for example, Annex 276 Div., Annex 276 Int. or Annex 276 R).

Belgian companies must also separately report on an annual basis payments made directly or indirectly to persons located in tax havens,[20] if the aggregate amount of such payments made during the taxable period amounts to at least EUR 100,000.[21]

2. Reporting obligations on professional income withholding tax

As a general rule, professional income withholding tax must be paid within a 15-day period following the month in which the wages were paid or attributed.[22] Belgian tax law, however, includes several exceptions to this rule.[23]

As from January 1, 2009, the withholding tax on professional income needs to be declared electronically through the online system "FinProf." The employer can request an exception if it does not have the necessary IT equipment. Upon approval of such request, the employer will be provided with the relevant documentation (Form 274-E), which it needs to complete and return to the competent "documentation center."

II. Application of Belgian withholding and reporting rules to cross-border payments

A. Compensation paid to Exec for Belgian services

As it appears from the fact pattern that HCo is paying Exec's compensation for the work performed, Article 270 of the BITC is triggered. Article 270 provides that professional income withholding tax is owed by Belgian residents (for tax purposes) that pay or attribute wages (*bezoldigingen/rémunérations*) in Belgium or abroad. Consequently, HCo is subject to withholding tax in Belgium. Assuming that FCo was paying Exec's compensation, no withholding tax would be due from HCo, provided the payments did not constitute professional costs that were attributed to FCo's PE — if any — in Belgium.

If Belgium has a standard tax treaty in place with Country X, HCo will be exempt from paying professional income withholding tax in Belgium if the three conditions listed in I.A.2., above are satisfied. Given that Exec is employed for only a four-month period, the maximum employment period of 183 days is not exceeded. The second and third conditions may, however, create an issue, as these require that: (2) the employment income be paid by, or on behalf of, FCo; and (3) the payments not be borne by a PE of FCo in Belgium. Thus, in order for HCo (and Exec) to qualify for a tax exemption in Belgium, any employment-related payments made during, or attributable to, the period of secondment must be borne by FCo, which should remain Exec's employer[24] for those four months in question.

The rationale for these requirements is to avoid the source taxation of short-term employments for as long as the employment income is not a deductible expense in the source State, given that the employer is not taxable in that State (either as a resident or through a PE it maintains there).[25] It should, however, be taken into account that, if FCo remains Exec's employer during the secondment, this in and of itself might give rise to the possibility of Exec's presence in Belgium creating a PE of FCo in Belgium.[26]

As regards reporting obligations, see I.B.2., above.

B. Royalties paid on sublicense

Assuming no tax treaty is in effect between Belgium and Country X, royalties on HCo's sublicense to SisterCo would be subject to Belgian withholding tax, at the rate of 25 percent. However, the tax treaty between Belgium and Country X, as described in the fact pattern, results in such royalty payments being exempt from Belgian withholding tax.

In this context, however, it is worth noting that most of Belgium's tax treaties contain a "limitation-on-benefits" ("LoB") clause. For a person to be entitled to treaty benefits, the person is generally required to be a resident of Belgium (or the other Contracting State), as the case may be, and to pass a series of highly specific anti-treaty shopping provisions.[27] In addition, a general *bona fide* motive test will require SisterCo to establish "that the principal purpose of the company, the conduct of its business and the acquisition or maintenance by it of the shareholding or other property from which the income in question is derived, are motivated by sound business reasons and thus do not have as a primary purpose the obtaining of any such benefits."[28] This *bona fide* provision, imputed through the OECD, is similar to the criterion of "legitimate financial and economic needs" used in several of Belgium's anti-abuse provisions already enacted.[29]

In addition, most tax treaties concluded by Belgium include the following provision:

> Royalties arising in a Contracting State and paid to a resident of the other Contracting State shall be taxable only in that other State if such resident is the *beneficial owner* of the royalties.[30] [Emphasis added.]

The question of whether SisterCo qualifies as the beneficial owner of the royalties paid by HCo could be the subject of a wholly separate discussion and will depend on the specific circumstances of the case. For instance, SisterCo will more likely be considered the beneficial owner if it performs an active role in the licensing activities and the entire business process, for example, managing efforts to ensure that the IP rights are enforced against potential infringers. Moreover, SisterCo cannot be acting as: (1) a mere intermediary (such as an agent) receiving income in the name and for the account of a third party; (2) a mere fiduciary; or (3) an administrator acting on account of third parties.[31] The 95 percent royalties paid on to FHoldCo will also be taken into account in this discussion, as the funds that are retained in the hands of SisterCo should at least be greater than what an independent third party would be willing to pay to a mere agent, fiduciary or administrator so there is some real indication of a profit in exchange for entrepreneurial risk here.[32]

With regard to reporting obligations in Belgium, HCo will need to report the royalty payments within 15 days of the attribution or payment of the payments[33] by filing Form 273 or Form 273S, depending on whether or not the intellectual property at issue is copyrighted. In these Forms, HCo must report the following: the amount of royalties paid; the taxable amount of the royalty payments; the applicable tax rate; the amount of the withholding tax; any reductions and exemptions being claimed, together with an explanation of the basis for same; the date of attribution or payment; the effective date of the sublicense; the end date of the sublicensing agreement; and SisterCo's identity. Given that HCo's royalty payments to SisterCo are exempt from tax pursuant to the tax treaty with Country X, HCo will have to complete and attach to its withholding tax declaration an Annex 276 R, indicating that and proving how all the conditions under the tax treaty are satisfied.

Finally, SisterCo will not be subject to Belgium's income tax withholding and reporting obligations with respect to the royalties it pays to FHoldCo but that are attributable to HCo's Belgian exploitation of the IP. This is because, unlike the United States, Belgium has not adopted the concept of a "second-tier withholding tax."

C. Interest paid by HFund to Lender

In order to address the third question in the fact pattern, it is first necessary to determine: (1) what constitutes a partnership under Belgian law; and (2) whether payments on a loan with an "equity kicker" constitute interest payments for tax purposes or whether they should be treated as dividend payments.

1. Company or fiscally transparent entity?

As it is rather difficult to pigeonhole each type of Belgian entity as being or not being the equivalent of a partnership, given some of the important differences in company law concepts, the more relevant question is whether HFund would be viewed as being fiscally transparent. In order for an entity to be subject to Belgian corporate income tax, the following criteria must be satisfied:[34]

- the entity must have its fiscal domicile in Belgium;
- the entity must have legal personality; and
- the entity must engage in operations of a profit-making nature.

Belgian tax law does not, by contrast, provide a clear definition of the concept of "fiscal transparency" or the criteria an entity must satisfy in order to be considered fiscally transparent.[35] Belgian doctrine and case law do stipulate that the absence of legal personality[36] is the decisive factor in determining whether an entity is fiscally transparent.[37]

Considering that HFund is organised and has its offices in Belgium, it can be assumed that its fiscal domicile is located in Belgium. Moreover, as HFund's main activities consist in investing and trading in stocks and securities, it also engages in operations of a profit-making nature. Therefore, determining whether HFund is a company or a transparent entity for Belgian (corporate) income tax purposes will eventually depend on whether or not it has legal personality, for which sufficient facts have not been provided.

2. Interest or dividend payment?

The "equity kicker" tied to HFund's performance in the fact pattern raises the risk of the interest payments being treated as dividend payments. As Belgian tax law does not expressly define the concept of a "loan," one must refer to the Civil Law meaning of the term.[38] Belgian Civil Law considers the substantial defining attribute of a loan to be the right to a repayment of funds placed at a borrower's disposal, without those funds being subject to the borrower's own operational risk. If this attribute is present, even if some or all of the remuneration for the loan is a participation in the borrower's profits, if the loan is convertible into shares[39] or if the interest payments are classified as dividends in the lender's jurisdiction,[40] the payment will still be treated as interest in Belgium. Thus, on balance, the authors believe it can be assumed that the interest payments made by HFund will in fact be considered interest payments for Belgian tax purposes.

3. Withholding and reporting obligations

HFund will have to withhold 25 percent on the interest payments to Lender, as the prospects of the payments qualifying for any withholding tax exemptions do not appear to be promising in this case.

First, for HFund's payments to qualify for the withholding tax exemption under the EC Interest and Royalties Directive, HFund and Lender would need to constitute "associated companies," meaning that: (1) one of them would have to hold directly at least 25 percent of the capital of the other; or (2) a third EU company would have to hold directly at least 25 percent of the capital of both of them.[41] Assuming that HFund and Lender are not fiscally transparent, the exemption will not likely apply since Lender is not an investor in HFund and can therefore not be regarded as an associated company of HFund. And then, if Lender is fiscally transparent, the Directive will also not afford HFund relief, as Lender's investors are individuals, so that HFund and Lender cannot be considered associated "companies."

Belgium also exempts payments made by fiscally transparent communal investment funds to their investors.[42] However, this exemption only applies to payments made in return for equity investments in such funds and does not apply to payments made in return for a loan.

Finally, it should be noted that Belgium exempts payments made to Belgian communal investment funds from withholding tax.[43] However, this favourable regime is not available for European investment funds (that are similar to communal investment funds) that are not located in Belgium. It can be considered questionable whether this is in compliance with the European Union principle of free movement of capital,[44] as EU law forbids discriminatory treatment of European companies based on their country of origin. Belgium has already been condemned for not exercising its taxing powers in compliance with EU law.[45] Therefore, if Lender is an investment fund similar to a communal investment fund and if Lender is based in the EU, this particular exemption might apply. Unfortunately, it is likely that, for that view to prevail, Lender would have to take the case all the way to the Court of Justice of the European Union for a preliminary ruling that not extending the exemption to other EU-based funds is incompatible with EU law.

The reporting obligations with respect to interest payments are similar to the reporting obligations with respect to royalty payments (see II.B., above).

NOTES

[1] The authors would like to thank Mr. Pietjan Gythiel for his invaluable contributions to this paper.

[2] This rate applies to income attributed or made payable on or after Jan. 1, 2013, pursuant to the Law of Dec. 27, 2012.

[3] BITC, Art. 267.

[4] E.g., a debtor contractually agreeing to bear the burden of withholding tax payments would automatically result in a financial advantage for the beneficiary. Consequently, the amount of such payments must be grossed up or added to the amount of the income used to calculate the withholding tax, resulting in a "tax on tax."

[5] EC Interest and Royalties Withholding Tax Directive (2003/49/EC) of June 3, 2003, implemented by RD of Dec. 22, 2003, Belgian Official Gazette Dec. 21, 2003 and Law of July 4, 2004, Belgian Official Gazette Sept. 7, 2004 (the "Interest and Royalties Directive").

[6] EC Interest and Royalties Directive, Art. 3, b.

[7] RD of Dec. 21, 2006, Belgian Official Gazette Dec. 29, 2006

[8] EC Parent-Subsidiary Tax Directive of July 23, 1990 (90/435/EEC), O.J. No. L/225, at 6 (Aug. 20, 1990), as amended by EC Directive of Dec. 22, 2003 (2003/123/EC), O.J. No. L/007, at 41 (Jan. 13, 2004).

[9] G. Bombeke & A. Huyghe, *Dividends*, in A. Van de Vijver, ed., The New US-Belgium Double Tax Treaty: A Belgian and EU Perspective 171, 184 (2008).

[10] H. Liebman and M. Jonckheere, *Beneficial Ownership—Host Country: Belgium*, 33 Tax Management Int'l F. 9, at 11 (Dec. 2012).

[11] OECD Model Convention, Arts. 10 (Dividends), 11 (Interest), and 12 (Royalties).

[12] BITC, Art. 272, 1°.

[13] BITC, Art. 270, 1°.

[14] BITC, Art. 273, 1°.

[15] RD/BITC, Art. 87.

[16] This is the date on which the beneficiary effectively has the income at its disposal.

[17] If withholding tax is in fact due, the debtor will have to pay it over to the authorities within that same 15-day period (BITC, Art. 412).

[18] As from Jan. 1, 2012, taxpayers subject to withholding tax can file the relevant declaration online through www.rv-on-web.be. The option to file a "hard copy" withholding tax declaration remains available.

[19] C. Chevalier, Vademecum Vennootschapsbelasting, 636 (2013).

[20] A country is considered to be a tax haven for these purposes if: (1) it is considered by the OECD Global Forum to be a country that does not apply the OECD exchange of information standards; or (2) it is one of the countries listed in RD/BITC, Art. 179. Examples of jurisdictions listed in the RD/BITC include Abu Dhabi, the Bahamas, Dubai and Monaco.

[21] BITC, Art. 307, § 1.

[22] BITC, Art. 412.

[23] E.g., if the withholding tax levied on the income during the preceding year was less than EUR 31,090, the withholding tax is payable within a 15-day period following the trimester in which the wages were paid (BITC, Art. 412, sec. 3).

[24] The interpretation of the term, "employer" remains somewhat ambiguous, as certain countries opt for a formalistic approach (i.e., the employer on paper) and others choose to adopt a substantive approach (thereby requiring an actual relationship of authority).

[25] OECD Model Tax Convention on Income and on Capital (July 2010), Commentary on Art. 15, at para. 6.2.

[26] Provided Exec engages in significant commercial activity on behalf of FCo while in Belgium or otherwise conducts activities that risk PE classification, such as signing contracts on behalf of FCo.

[27] A. Bax & F. Dierckx, *Limitation on Benefits*, in A. Van de Vijver, ed., The New US-Belgium Double Tax Treaty: A Belgian and EU Perspective 421, 421 (2008).

[28] OECD Conduit Companies Report, para. 42(i).

[29] T. Jansen & P. De Vos, Handboek internationaal en Europees belastingrecht 639 (2006).

[30] Belgian Draft Model Convention, Art. 12(a).

[31] *Cf.* J. Van Gompel, *Interest*, in A. Van de Vijver, ed., The New US-Belgium Double Tax Treaty: A Belgian and EU

Perspective 205, 218 (2008), citing the legislative history of the U.S.-Belgium Tax Treaty, as reported in Belgian Chamber session 2006-2007, April 16, 2007.

[32] H. Liebman & M. Jonckheere, fn. 10, above, at 13.

[33] If withholding tax is due, HCo will have to pay it within 15 days.

[34] BITC, Art. 179 and Art. 2, § 1, 1°.

[35] A. Haelterman, Fiscale transparantie — Theorie en praktijk in Belgïe 29 (1992).

[36] K. De Haen, *Fiscale transparantie in België: "OESO (graag nog meer) als leidraad voor Rechter en Ruling,"* AFT March 2008, 19.

[37] In fact, Belgian doctrine generally distinguishes between perfect and imperfect fiscal transparency, but a full exposition on this subject is beyond the scope of this paper.

An example of a fiscally transparent entity under Belgian law is the "communal investment fund" (*gemeenschappelijk beleggingsfonds/ fonds commun de placement*), consisting of a fiscally transparent pooling of assets, without legal personality, that is managed by a management company.

[38] P. Smet and S. Martin, *New Trends in the Tax Treatment of a Corporation's Cross-Border Interest*, TFR 15 Oct. 2009, 763.

[39] Com. IB 1992, nr. 19/35.

[40] Fiscal ruling 700,065 dated June 5, 2007. In this ruling, a profit-participating convertible, reverse convertible and subordinated loan were considered to yield fiscally deductible interest payments, even though such interest payments were characterised as dividends in the lender's home country.

[41] EC Interest and Royalties Directive; RD/BITC, Art. 107, § 6.

[42] RD/BITC, Art. 109.

[43] RD/BITC, Art. 106 § 3.

[44] Treaty on the Functioning of the European Union (TFEU), Art. 63.

[45] See, e.g., ECJ, Jan. 17, 2008, Case No. C-105/07, *NV Lammers & Van Cleeff v. Belgium*.

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