THE COMPATIBILITY OF THE BELGIAN FAIRNESS TAX WITH EU LAW AND INTERNATIONAL LAW

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Introduction

In July 2013, Belgium introduced a new corporate tax called the "Fairness Tax" as part of the tax generating measures of the second Federal budget control of that year[2]. The Fairness Tax consists of a special contribution of 5,15% applicable to companies. It entered into force from the fiscal year 2014.

Given its ratio legis, the introduction of the Fairness Tax was certainly the major action recently taken towards multinational companies established in Belgium. The name given to this contribution is not left to chance; it fits perfectly into the ongoing BEPS debate intended to strengthen the fairness of tax systems and uphold their integrity[3]. The resulting amendment of the Belgian Income Tax Code (CIR 92)[4] reflects the substantial criticisms raised against multinational companies established in Belgium almost exclusively in order to benefit from tax incentives such as the deduction for risk capital (better known as the notional interest deduction (NID)) or the unlimited carry-forward of tax losses.

Indeed, the purpose of the Fairness Tax is to affect large companies, which distribute dividends but do not pay any corporate tax in Belgium (or at least at a

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2 Loi du 30 juillet 2013 portant des dispositions diverses, *Moniteur Belge*, 1 Août 2013, p. 48.270.

3 OECD, Action Plan on Base Erosion and Profit Shifting (BEPS), 19 July 2013: <http://www.oecd.org/ctp/BEPSActionPlan.pdf> accessed 6 August 2014.

4 CIR 1992, art. 219ter, 198(1)1°, 207 §2, 218(1), 233 §3, 246 §1, 3°, 304(2) §2, 463bis(1)1°.

much lower effective rate), as a consequence of these deductions allowed under Belgian tax law. Although not called this way, one may say it amounts to a minimum tax for certain large companies, which offset a current year[5] NID or losses carried forward against their taxable income and distribute an amount of dividends considered as excessive.

To some extent, it thus represents a unilateral answer to forum shopping taken by Belgium along the actions developed on the international stage by the OECD and the G20. However, it will be argued in this paper that the Fairness Tax is no more than a budgetary measure which was once again poorly framed into the existing Belgian tax system. Missing its main purpose, it calls for an increased need of a broader tax reform.

Although presented as "fair" and even "simple"[6], this tax has been rather controversial at many levels: the Belgian Constitution, European Union (EU) tax law, as well as tax treaties.

Under constitutional law, the Fairness Tax seems to be in breach of certain principles such as the equality and non-discrimination principles and the legality principle. Nonetheless, this will not be the main focus of the present study. It will rather address in more details the compatibility issues under EU law and international law.

Important questions were rapidly raised regarding the compatibility of the Fairness Tax with primary and secondary EU law and double tax conventions (DTCs) concluded by Belgium.

As regards primary EU law, the question has been raised as to whether this new levy is compatible with the freedom of establishment conferred under the Treaty on the Functioning of the European Union (TFEU)[7] from a host State perspective. Since the chargeable event of the Fairness Tax is the distribution of dividends, many Belgian scholars also doubt the compliance of this new tax with the Parent-Subsidiary Directive[8] (Articles 4 and 5). In a situation where Belgium is the State

5 The stock of NID cannot be carried forward anymore since the *Argenta* decision: ECJ, 4 July 2013, C-350/11, *Argenta Spaarbank NV v Belgische Staat ('Argenta')* (not yet reported).

6 Projet de loi portant des dispositions diverses, rapport fait au nom de la commission des affaires sociales, *Document parlementaire*, Chambre, 2012-2013, n°53-2891/7, p. 37.

7 TFEU, art. 49 to 55.

8 Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (recast) [2011] OJ L345/8.

of establishment of the subsidiary company, the Fairness Tax may be considered as a hidden withholding tax on the profits distributed by a Belgian subsidiary to its foreign parent company instead of an additional corporation tax on operational income (Article 5). In the reversed situation, where Belgium is the State of establishment of the Parent company, it does not seem to comply either with Article 4, §1 of the Directive. It concerns the taxation of dividends received by mixed holding companies and redistributed to their parent company.

The Belgian government itself notified the Fairness Tax to the European Commission[9].

As regards DTCs concluded by Belgium, this levy might lead to a breach of Article 7 (in conjunction with Article 23) of the OECD Model Tax Convention generally followed by Belgium in its tax treaties, provided the Fairness Tax falls under its material scope in light of Article 2.

Most interesting is the fact that Belgium is not the only jurisdiction adopting this kind of corrective tax measure; France for instance has introduced a similar additional tax of 3% as from August 2012[10]. This paper may therefore also be of great interest regarding other countries.

This paper will proceed as follows. In an attempt to provide a clear understanding of this new Belgian tax, it will start by analysing its technical features, taking into account the legal developments undertaken by the end of September 2014 (Part I, A). It will subsequently analyse the ratio legis standing behind the adoption of the Fairness Tax, in relation with the wider BEPS framework (Part I, B). Finally, the crux of the present paper (Part II and III) will examine the compatibility issues regarding firstly EU tax law and secondly tax treaties.

9 Projet de loi portant des dispositions diverses, rapport fait au nom de la commission des affaires sociales, *op. cit.*, p. 38.

10 Loi n°2012-958 du 16 août 2012 de finances rectificatives pour 2012, article 6, modifiant l'article 235ter ZCA du Code général des impôts, JORF n°0190 du 17 août 2012, p. 13479.

Part I. Fairness Tax

A. Technical aspects

1) Separate corporate tax assessment

The Fairness Tax is a standalone tax of 5,15% (5% rate plus a 3% austerity surcharge)[11] computed along the traditional Belgian corporate tax of 33,99%[12].

Although it is not formally called this way, it is sometimes envisaged as a minimum levy[13] applicable to multinational companies established in Belgium mainly in order to erode taxation. However, the so-called “minimum tax” is not applicable in every case: it will apply only to the extent that a company is not effectively taxed on its current-year profits (or part of it) as a result of the NID and the carry-forward of losses and distributes dividends to its shareholders out of these untaxed profits.

The reason why it is expected to affect mainly large companies is because both tax deductions are believed to be used significantly by multinational enterprises and not much by small and medium enterprises.

Several consequences flow from the separate assessment of the Fairness Tax. Just as the main corporation tax, the Fairness Tax is excluded from the business expense of companies[14]. Moreover, none of the tax deductions available under Belgian law such as the exempt income, the NID, the carry-forward of losses, the deduction for patent income, the participation exemption, as well as current year losses can be deducted from the taxable base of the Fairness Tax[15]. It implies that, when the conditions for its applicability are met, the tax is almost always due, endorsing the idea that it constitutes a minimum tax for the targeted companies, the more likely to take advantage of the NID and the carry-forward of losses.

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11 Howard M. Liebman and Werner Heyvaert, ‘The Belgian Fairness Tax: A comparison with the U.S. Alternative Minimum Tax’ (2014) 42 Tax Audit and Accountancy 27.

12 CIR 1992, art. 219ter(1).

13 Howard M. Liebman and Werner Heyvaert, *op. cit.*

14 CIR 1992, art. 198(1)1°.

15 CIR 1992, art. 207 §2 and art. 219ter(5).

2) *Scope*

a) Targeted companies

"The Fairness Tax applies to companies subject to corporate income tax in Belgium"[16]. They must also meet two conditions: the distribution condition and the lower taxation condition.

On the one hand, are liable for the Fairness Tax companies that have distributed dividends out of profits of the current year. On the other hand, these companies must not have been effectively taxed on the profits (or part of the profits) that have been distributed and so as a result of the relevant Belgian tax incentives. This explains why companies will only be liable to pay a Fairness Tax where the amount of dividends distributed exceeds the company's taxable base.

The reason why profits would not have suffered taxation at the ordinary rate of tax of 33,99% is either "because they are in a position of tax loss" or because they "benefit from the NID"[17]. In other words, "the Fairness Tax does not apply when a company [has not distributed dividends] or has distributed dividends in a certain year and has not utilized NID and/or tax loss carry-forwards in that year"[18].

b) Targeted incentives

Introduced in 2005, the NID allows companies subject to full tax liability in Belgium to claim tax relief for a hypothetical amount of interest, calculated as a percentage of their equity capital, when establishing the basis of assessment for corporate tax. At the time, this deduction was meant to constitute an EU-proof alternative to the coordination centre regime, previously considered as a state aid by the European Court of Justice (ECJ)[19]. The corporate taxpayers taking advantage of NID often include companies acting as "intra-group" banks by being involved in cash-pooling operations of their group and therefore having a high

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16 Bob Michel and Pieter Van Den Berghe, 'Fairly Odd: Belgium's New Fairness Tax' (2014) 54 No 6 European Taxation IBFD, p. 223.

17 BDO Belgium, 'Second Budget Control Involves New Tax Measures' (1 August 2013): <http://www.bdo.be/en/news/professional-news/2013/tweede-begrotingscontrole-brengt-nieuwe-fiscale-maatregelen-met-zich-mee/> accessed 6 August 2014.

18 PricewaterhouseCoopers, 'Belgium proposes a fairness tax on dividend distributions' (*European Tax Newsalert*, 18 July 2013): <http://www.pwc.com/en_US/us/tax-services-multinationals/newsletters/european-tax-newsalert/assets/pwc-belgium-proposes-fairness-tax.pdf> accessed 6 August 2014.

19 ECJ, 22 June 2006, C-182/03 and C-217/03, *Kingdom of Belgium and Forum 187 ASBL v Commission of the European Communities ('Belgium v Commission'),* [2006] ECR I-5584.

level of assets. Since the legislative reform triggered by the *Argenta* decision of the ECJ[20], the carry-forward of a stock of notional interests over 7 years is no longer possible. The benefit from the NID is thus limited to the computation of notional interests for the current taxable year.

Whereas the NID is peculiar to a limited number of countries, the carry-forward of losses is spread to a much greater extent in other countries. It allows companies to set the current year's losses against future years' profits and thereby to reduce their tax liability. The carry-forward is unlimited in time in Belgium[21], with the consequence that companies having incurred losses in the past can sometimes avoid paying taxes on further profits for years.

The use of other tax deductions, such as the patent income deduction, the participation exemption under the parent-subsidiary Directive or the investment deduction, is irrelevant for the application of this additional tax[22].

c) Large companies

The scope of application of the Fairness Tax is circumscribed to Belgian companies, which are not considered as “small companies”[23] within the meaning of Article 15 of the Belgian Companies Code[24].

The exemption of small companies has been disapproved by the Belgian Council of State (Conseil d’Etat) in its recommendation regarding the new tax for being contrary to the equality and non-discrimination principles under the Belgian Constitution (Articles 10, 11 and 172 of the Belgian Constitution).

Indeed, according to the jurisprudence of the Belgian Constitutional Court, a difference of treatment can only be permitted in cases where that difference of treatment is based on an objective criterion, is reasonably justified and meets a

20 *Argenta*, §§18-21.

21 CIR 1992, art. 206.

22 Circulaire AGFisc n°13/2014 (n°Ci.RH.421/630.788) du 3 avril 2014 <http://ccff02.minfin.fgov.be/KMWeb/document.do?method=view&nav=1&id=869495f0-cc92-434a-9af5-4754eca3caa2&disableHighlightning=true&documentLanguage=fr#findHighlighted> accessed 6 August 2014.

23 Small companies are those with the legal personality and which do not exceed more than one of the following limits per year: 50 workers employed by the company, EUR 7 300 000 turnover, EUR 3 650 000 balance sheet total. If the number of employed workers per year is more than 100, the company is not considered as small in any case.

24 CIR 1992, art. 219ter(7).

proportionality test[25]. The Council of State expressed the view that here the second requirement (reasonable justification) was not met at the preparatory work stage[26]. Indeed, relying on the wish of the government not to place small companies in a cumbersome position, the only justification given was that other differences of treatment between these types of companies had already been operated in the past. Although under certain circumstances it is indeed admissible to subject small companies to a more favourable tax regime, it does not seem to be the case here[27]. Considering the chargeable event which triggers its application, the Fairness Tax would only apply to small companies which make enough profits and decide to distribute them, and only to the extent that the dividend distribution exceeds the company's taxable base[28]. Therefore, the small companies to which the Fairness Tax would apply are clearly not as much affected by the burden the majority of small companies is usually facing[29].

Unfortunately, there was no further amendment of the explanatory memorandum before the statute was enacted so that there is still a risk for this difference of treatment to be unconstitutional.

Fortum Project Finance, the Belgian subsidiary of the Finnish company *Fortum*, challenged the validity of the relevant statute in front of the Belgian Constitutional Court (action for annulment – action en annulation) on different grounds, including the difference of treatment between small and larger companies at issue[30]. That legal action was taken in February 2014 so the judgment should not be expected before at least a year. It will hopefully shed some light over the different issues raised in front of the Court.

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25 Section de législation du Conseil d'état, avis n°53 666/1/3 du 10 juillet 2013 sur le projet de loi portant des dispositions diverses (*Document parlementaire*, Chambre, 2012-2013, n°53-2891/9, p. 7).

26 *Ibidem.*

27 *Ibidem.*

28 *Ibid.* p. 8.

29 *Ibidem.*

30 Michel Lauwers, 'Le Finlandais Fortum, premier à attaquer la « fairness tax »' *L'Echo* (Brussels, 5 February 2014 : <http://www.lecho.be/actualite/economie_politique_belgique/Le_Finlandais_Fortum_premier_a_attaquer_la_fairness_tax.9463014-3154.art> accessed 6 August 2014.

d) Branches of non-resident companies

In order to avoid discrimination based on the place of the seat of the company[31], the Fairness Tax also applies to non-resident companies with a permanent establishment in Belgium[32].

Therefore, the basis of calculation had to be adapted to permanent establishments, since by definition they do not distribute dividends. To fall under the scope of the Fairness Tax, "the dividends [subsequently] distributed by the foreign company [must] find their origin in a low taxed profit of the Belgian establishment in application of the aforementioned tax deductions"[33]. This feature of the Fairness Tax is analysed in a separate section below.

3) Tax base

The basis of assessment of the Fairness Tax is computed by means of a three-step formula.

a) Step 1

The first step seeks to determine the part of the distributed profits, which does not figure in the final corporate tax base pursuant to the relevant tax deductions (NID and carry-forward of tax losses). The starting point is the difference between the amount of gross dividends[34] distributed during the taxable year out of profits wholly or partly compensated with the deductions and the final taxable result of that period effectively subject to the tax rate of 33,99%[35].

b) Step 2

The figure thereby obtained is then reduced by "grandfathered" reserves, i.e. the amount of dividends resulting from previously taxed reserves retained prior or

31 Bob Michel and Pieter Van Den Berghe, *op. cit.,* p. 223.

32 CIR 1992, art. 233.

33 BDO Belgium, *op. cit.*

34 The definition of 'dividend' is to be found in CIR 1992, art. 18 §1, 1° and 2°: ordinary dividends, interim dividends, intermediary dividends, repayments of capital, issue premium to the extent the reimbursement does not relate to paid-in capital, by contrast with liquidation and redemption proceeds (Bob Michel and Pieter Van Den Berghe, *op. cit.,* p. 224).

35 CIR 1992, art. 219ter(2): the profit derived from capital gains exempt under corporation tax but subject to the standalone tax of 0,412% or 25,75% are not deducted here and are therefore part of the Fairness Tax base.

during tax year 2014 at the latest[36]. The reserves built up as of tax year 2015 will thus not be excluded. Companies should apply a last-in-first-out (LIFO) method[37], making it impossible to avoid the Fairness Tax by withdrawing the oldest reserves first[38].

Consequently, previously taxed reserves can be distributed by a company without being liable for the payment of any Fairness Tax. Nonetheless, as a result of the application of the LIFO method, if the distribution is postponed, for instance to 2017, the Fairness Tax will be due on the retained earnings built up in tax year 2015 and 2016 before the company is able to use the oldest reserves and be exempt from the payment of the Fairness Tax[39].

Regarding tax year 2014, distributions of current-year profit cannot be considered as being paid out of taxed reserves from tax year 2014 and thereby deducted from the Fairness Tax base of tax year 2014[40]. In other words, for the purpose of the payment of the Fairness Tax in 2014, only taxed reserves from tax year 2013 or before can be taken into account to reduce its tax base[41].

c) Step 3

The untaxed distributed profits obtained pursuant to steps 1 and 2 are then multiplied by a proportionality factor[42], the purpose of which is to limit the tax base only "to the extent that the lack of taxation results from the application of the NID and or carry-forward of tax losses"[43].

The proportionality factor can be computed as follows:

- the numerator equals to the NID and the carry-forward of tax losses "effectively deducted in the taxable period in connection with which the dividend is distributed"[44].

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36 CIR 1992, art. 219ter(3).

37 CIR 1992, art. 219ter(3).

38 Bob Michel and Pieter Van Den Berghe, *op. cit.,* p. 224.

39 Renaud Hendricé, 'Fairness Tax – Une cotisation "en réalité, assez simple"?' (2013) 8, Revue Générale de Fiscalité, p. 7.

40 CIR 1992, art. 219ter(3)§2; Circulaire AGFisc n°13/2014 (n°Ci.RH.421/630.788) du 3 avril 2014, *op. cit.*, §14.

41 Circulaire AGFisc n°13/2014 (n°Ci.RH.421/630.788) du 3 avril 2014, *op. cit.*, §14.

42 CIR 1992, art. 219ter(4).

43 Bob Michel and Pieter Van Den Berghe, *op. cit.,* p. 225.

44 *Ibidem.*

- the denominator equals to the corporate tax base calculated before any of these deductions but after the deduction of exempt impairments, provisions and capital gains (except those which are subject to a standalone tax on capital gains)[45].

4) Rate

The Fairness Tax rate is of 5,15% (5% plus a 3% crisis surcharge)[46].

5) Belgian branches of non-resident companies

Article 233 of the Income Tax Code (CIR 92) provides for the taxation of non-resident companies on their Belgian profits. This article states that the same rules apply to foreign companies and clarifies what needs to be understood by the words "distributed dividends" regarding permanent establishments. Indeed, branches strictly speaking do not distribute dividends to their head office (as they do not have a separate legal personality) and the dividends distributed by the head office itself to its shareholders do not find their source exclusively in Belgium. Therefore, the legislator had to come up with a stricter definition. For the purpose of the Fairness Tax, distributed dividends shall mean the part of the gross dividends distributed by the non-resident company which "corresponds to the positive share of the accounting result of the Belgian establishment in the total accounting result of the company"[47].

It must be noted that this clarification does not provide much help to practitioners, as many questions are still left open. Surprisingly, the administrative circular released by the Belgian tax administration in May 2014 did not address this issue. One shall wait for tax rulings or judgments to fill this statutory gap, which is not far from violating the constitutional principle of legality in some scholars' view[48].

45 Circulaire AGFisc n°13/2014 (n°Ci.RH.421/630.788) du 3 avril 2014, *op. cit.*, §§16-17.

46 CIR 1992, art. 219ter(6) and 463bis(1)1°.

47 Bob Michel and Pieter Van Den Berghe, *op. cit.,* p. 225.

48 M. Dhaene and A. Brohez, 'De fairness tax: een grondige analyse en enkele bedengen omtrent de verenigbaarheid met hogere rechtsnormen' (2013) 451 Tijdschrift voor Fiscaal Recht, p. 899.

B. Ratio legis and desirability of the Fairness Tax

1) Ratio legis

The key justification to this new tax is supposedly to limit the favourable treatment enjoyed by certain large companies in Belgium by restricting the excessive use of unlimited carry-forwards of losses and of NID[49].

According to the preparatory work of the Law of 30 July 2013, containing miscellaneous tax and financial provisions [50], despite the legality of these deductions, this has led to a situation where some companies are barely liable for any tax in Belgium whereas other companies which have a much lower level of assets (basis of the NID) or a much lower stock of previous tax losses (or none) to carry forward, are still liable for corporate tax at a full 33,99% nominal rate. This situation was deemed unfair towards those corporate taxpayers which were in a situation where they could not make any use of the relevant deductions. Therefore, the government decided to create a specific tax targeting these companies in order to correct this unfairness.

However, the money that would allegedly be raised by means of the Fairness Tax under the cloak of equity (EUR 140 million[51]) is mainly expected to reduce the public debt. This amounts to nothing more than a mathematical formula: new tax, new revenue.

The ratio legis of the Fairness Tax is thus twofold: on the one hand it is aimed at "recouping some of the budgetary costs of"[52] the NID introduced in 2005 and of the unlimited nature of the carry-forward of losses, and on the other hand it will answer the indignation expressed by the public opinion at a situation considered as 'unfair'.

This raises two questions, the answer to which might cast doubt on the desirability of the Fairness Tax in view of its purported aim. To which extent does the Fairness Tax bring an end to the 'unfairness' of these tax benefits? And to which extent will the Fairness Tax actually raise money?

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49 Projet de loi portant des dispositions diverses, rapport fait au nom de la commission des affaires sociales, *op. cit.*, p. 38.

50 Loi du 30 juillet 2013 portant des dispositions diverses, *op. cit.*

51 Bob Michel and Pieter Van Den Berghe, *op. cit.,* p. 227.

52 *Ibid.*, p. 228.

2) *The loss of revenue resulting from the NID and the carry-forward of losses*

a) The NID cost

By and large, figures from the Report drafted by the Joint Parliamentary Commission on a reform of the Belgian tax system estimate the budgetary cost of the NID to EUR 6 billion in 2012[53]. The loss of tax revenue is evaluated by assessing the tax yield that would result from the removal of the NID in light of the downstream effects of that removal (i.e. the fact that the NID may be replaced by other deductions, mainly the carry-forward of previous losses)[54]. However, the Report recognises that these figures are missing different elements[55].

Firstly, it does not take account of other measures that were taken in order to compensate the introduction of the NID[56].

Secondly, its cost in budgetary terms is nothing more than the transposition, under another form, of the costs previously incurred under the Coordination Centre Regime[57]. Indeed, following its removal, the NID was mainly introduced to provide a new tax incentive to multinational enterprises which had established a company in Belgium acting as an "intra-group" bank for their group.

On top of that, according to Frédéric Panier, heard in front of the Belgian Joint Commission in charge of a reform of the Belgian tax system in September 2013, the NID regime has led to an influx of companies (mainly French companies) establishing in Belgium in 2007 without any employee[58].

Hence, the NID usually applies to companies which were originally located in Belgium exclusively or mainly to benefit from this tax incentive and which, besides their financial function, do not have any substance such as offices, equipment or employees in Belgium.

53 Rapport fait au nom de la commission parlementaire mixte en charge de la réforme fiscale du 24 février 2014, la réforme fiscale, *Document Parlementaire*, Chambre, n°53-3343/1, p. 140.

54 *Ibidem*.

55 *Ibidem*.

56 *Ibidem*

57 *Ibidem*

58 Commission parlementaire mixte chargée de la réforme fiscale du mardi 24 septembre 2013, Document Parlementaire, audition de M. Frédéric Panier, *Document Parlementaire*, Chambre, n°53-F007, p. 13.

Therefore, it is extremely dubious to claim that the amount of the NID used by some companies equals to the actual loss of revenue incurred by Belgium. One should wonder if these companies would have established themselves in Belgium in the first place without the existence of such incentive.

Finally, the figures do not take account either of the fact that some increases of equity would not have taken place if the NID had not been introduced. These increases of equity might even have had a positive impact in cases where the Belgian tax base remained positive after all the deductions available to the corporate taxpayers[59].

It results from the above that estimates of costs are very complicated[60]. This paper is therefore not claiming that the NID should not be removed or counterbalanced by a measure such as the new Fairness Tax. It only highlights the fact that the relation between the total amount of deductions that these companies have taken advantage of and the money actually lost by the State is not a clear-cut one.

b) The cost of the carry-forward of losses deduction

Regarding the yearly cost of the carry-forward of tax losses, it ranges from EUR 4 to 5 billion per year[61]. The stock of losses available is actually much higher but the carry-forward of losses is rather slow because of the sequence of tax deductions (the carry-forward of losses comes after the NID, the participation exemption and the patent income deduction)[62].

3) The unfairness of the NID

The NID (and to a lesser extent the carry-forward of losses) has been considered for long by the public opinion as unfair: why can some companies legally avoid contributing to public finances at the expense of other taxpayers?

However, as examined in the previous section, the issue of the Belgian NID regime is not much one of loss of revenue for Belgium but rather one of loss of revenue for foreign jurisdictions. Described as a 'weapon of mass destruction'

59 Rapport fait au nom de la commission parlementaire mixte charge de la réforme fiscale du 24 février 2014, *op. cit.*, p. 140.

60 This is something the Belgian Joint Commission will be working on.

61 Rapport fait au nom de la commission parlementaire mixte charge de la réforme fiscale du 24 février 2014, *op. cit.*, p. 142.

62 *Ibidem.*

against foreign tax authorities by Frederic Panier, this tax benefit erodes other countries' tax bases much more than it represents a cost for Belgium[63].

By being able to lower considerably the effective rate of taxation of certain companies, the NID might be considered as a harmful tax practice in light of the OECD standards[64].

Although the NID regime was not found to be harmful under the current version of the OECD Report on harmful tax competition, the factors to be used to identify harmful practices may be amended in the BEPS framework in which case it may result in a new assessment of the NID[65].

4) The impact of the Fairness Tax

In this respect, the Fairness Tax may seem to participate indirectly in the developments of the BEPS project. Nonetheless, this was not referred to in the preparatory work, which focuses on the unfairness towards other taxpayers rather than towards other tax jurisdictions.

Regarding its budgetary function, the creation of a new source of revenue for Belgium is not guaranteed. Indeed, it is difficult to anticipate the effects of a tax reform. It may lead to a change in taxpayers' behaviour, eventually leading to another tax shift, in turn leading to further tax planning. A never ending story.
First of all, there is a risk that the targeted companies move out of Belgium and therefore cease being liable to tax in Belgium.

As stated by Bruno Colmant, the Fairness Tax is also promoting self-financing of companies[66]. Indeed, as long as a company's profits are retained in full (or to the extent that it does not exceed its final tax result), it will be possible to get around this additional levy[67]. Interestingly, it emerges from the annual financial statements of Belgian financing companies of significant groups of companies such as Ikea,

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63 Commission parlementaire mixte chargée de la réforme fiscale du mardi 24 septembre 2013, audition de M. Frédéric Panier, *op. cit.*, p. 13.

64 OECD, Report on Harmful Tax Competition (1998): <http://www.oecd.org/tax/transparency/44430243.pdf> accessed 6 August 2014.

65 Commission parlementaire mixte chargée de la réforme fiscale du lundi 18 novembre 2013, audition de M. Pascal Saint-Amans, *Document Parlementaire*, Chambre, n°53-F021, p. 14.

66 Michel Lauwers, 'La "fairness tax" encouragera l'auto-financement' (Brussels, 2 July 2013): <http://www.lecho.be/dossier/budget20132014/La_fairness_tax_encouragera_l_autofinancement.9369703-7407.art> accessed 6 August 2014.

67 *Ibidem*.

HP or Belgacom that they systematically retain all their profits instead of distributing them[68].

Furthermore, in such cases, it will have the other adverse consequence that it will raise their equity capital and thereby inflate the basis for the NID [69].

To sum up, the Fairness Tax was introduced in order to fix the issues resulting from the application of the NID but, in doing so, made the tax rules even more burdensome than before and arguably without making the companies' liability fairer.

Part II. Compatibility of the Fairness Tax with EU law

1) Freedom of establishment

According to Pr. Marc Dassesse, the treatment of non-resident companies with Belgian branches may be discriminatory or constitute a restriction under the regime of the Fairness Tax. Depending on the interpretation that will be given to the Income Tax Code (CIR 92), non-resident companies would arguably be less favourably treated than resident companies, in light of the notion of 'distributed dividends' which constitutes the basis of the Fairness Tax[70].

As pointed out in the first part of the present study, the application of the Fairness Tax to non-resident companies needed some adjustment. However, the only existing guidance is located in Article 233 CIR 1992. It provides that, for the purpose of the Fairness Tax, 'distributed dividends' shall mean the part of the gross dividends distributed by the non-resident company which "corresponds to the positive share of the accounting result of the Belgian establishment in the total accounting result of the company"[71].

So far, two elements seem to question the compatibility of that feature of the Fairness Tax with the freedom of establishment enshrined in the TFEU[72]:

68 *Ibidem.*

69 *Ibidem.*

70 Marc Dassesse, 'La Fairness Tax: contraire au droit européen?' (2013) 33 Actualités fiscales, p. 4-5.

71 Bob Michel and Pieter Van Den Berghe, *op. cit.*, p. 225.

72 TFEU, art. 49 to 55.

- the first one has to do with the practical implementation of the Fairness Tax regarding Belgian branches of non-resident companies, in particular the accounting method used by the company to compute its profits.
- the second one concerns the extent to which the total amount of dividends distributed by the foreign company and its total accounting result are taken into account to assess the Fairness Tax due by the company in Belgium.

a) Accounting rules to follow

Regarding the accounting method used to compute the company's profits, one of the question to which neither the Income Tax Code (CIR92), nor the administrative circular seems to answer is how one needs to understand the terms "accounting result". Do the total accounting result of the company and the share attributed to its Belgian branch have to be computed according to Belgian accounting rules? It is rather unclear[73].

According to Article 107, §1 of the Belgian Companies Code (Code des Sociétés), foreign companies with a branch located in Belgium must submit their annual accounts as well as their consolidated accounts to the national bank of Belgium but they may do so in the form in which these accounts have been drawn up, controlled and published according to the law these companies are subject to.

Nonetheless, in order to benefit from the NID (the base of which is the equity capital of the company with some adjustments), companies must draw up their accounts according to the Belgian accounting rules on a voluntary basis[74]. In cases where a company has benefited from the NID and has therefore voluntarily drawn up its accounts in that form, it would not be a problem if that was required for the application of the Fairness Tax as well. That could be problematic, however, in a situation where a company has not benefited from the NID but is liable to the Fairness Tax as a result of a carry-forward of losses. This might amount to a restriction of the freedom of a company having its seat in another Member State to establish itself in Belgium, which is incompatible with Article 49 TFEU.

At the time the NID was extended to foreign companies with a branch in Belgium provided they submit their financial statement in accordance with Belgian accounting rules, the *Futura* judgment (C-250/95)[75] of the ECJ was invoked in order to justify that voluntary approach.

73 Bob Michel and Pieter Van Den Berghe, *op. cit.,* p. 225.

74 AR/CIR 1992, art. 73/4septies.

75 ECJ, 15 May 1997, C-250/95, *Futura Participations SA and Singer v Administration des contributions ('Futura'),* [1997] ECR I-2471.

According to Pr. Marc Dassesse, it seems unlikely that this solution may be applied in a similar manner to the Fairness Tax on the ground that the Fairness Tax is a compulsory levy rather than a tax advantage[76]. It would mean that the taxpayer is not deliberately choosing to suffer the administrative burden of maintaining its accounts in a manner which differs from the one imposed in its country of origin.

The *Futura* case involved "Luxembourg tax rules which denied the carry-forward of losses of a Luxembourg branch of a French company unless the company demonstrated that the losses were linked to the Luxembourg territory and that the French company kept a set of accounts drawn up according to Luxembourg rules at the branch in Luxembourg"[77]. It was thus dealing with the granting of a tax advantage likely to lower companies' taxable base and not with the tax liability itself.

In *Futura*, the ECJ determined that the rules at issue (not regarding the part related to the economic link requirement but related to the keeping of accounts) were incompatible with EU law. The French company's freedom of establishment was restricted as a result of the additional administrative burden it suffered if the company wished to be allowed to carry forward the previous losses incurred by its branch. The government of Luxembourg relied on the effectiveness of fiscal supervision to justify the restrictive feature of its national rules. Referring to *Cassis de Dijon* (C-120/78)[78] where that justification had been accepted as an overriding reason of general interest, the Court ruled that "a Member State may therefore apply measures which enable the amount of both the income taxable in that State and of the losses which can be carried forward there to be ascertained clearly and precisely"[79]. However, the proportionality test of the *Gebhard* formula[80] required to examine whether the challenged rules went beyond what was necessary to achieve the effectiveness of fiscal supervision. The Court answered in the affirmative, considering that it was sufficient to require from the taxpayer to "demonstrate, clearly and precisely, the amount of losses concerned"[81].

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76 Marc Dassesse, *op. cit.*, p. 5.

77 Tom O'Shea, 'European Tax Controversies: A British-Dutch Debate: Back to Basics and Is the ECJ Consistent?' (2013) February, World Tax Journal, p. 123-124.

78 ECJ, 20 February 1979, C-120/78, *Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein ('Cassis de Dijon')*, [1979] ECR 649.

79 *Futura*, §31.

80 ECJ, 30 Nov. 1995, C-55/94, *Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano ('Gebhard')*, [1995] I-4165.

81 *Futura*, §39.

In short, the burden of proof lies with the taxpayer but to do so, the latter may choose the means by which he wishes to provide the requested information (by drawing up accounts that comply with the relevant Luxembourg rules or in another manner).

This calls for two remarks.

Firstly, even though the NID is a tax advantage and can therefore be compared to the carry-forward of losses, one may question the voluntary approach adopted regarding the use of the NID by non-resident companies. Two options are available to taxpayers: either submit accounts that do not comply with Belgian accounting rules thus receiving no deduction for the notional interest or keeping accounts in the form required and being entitled to the deduction. However, it follows from *Futura* that there must be a third option: to demonstrate "clearly and precisely" through any other means the amount of notional interest pursuant to the relevant provisions of the Belgian Income Tax Code.

Indeed, a good implementation of the conclusion in *Futura* would be to give the opportunity to taxpayers to demonstrate that the rules of the NID regime can be applied to their situation in accordance with their underlying objective (for instance in accordance with the fact that some adjustments are made in order not to take account of elements which do not give rise to taxation in Belgium) by means of the method they prefer. Thus *Futura* does not seem to back up entirely the approach used regarding the NID either.

Secondly, even if that voluntary approach could be justified under EU law in order to benefit from the NID, it surely is not the case regarding the application of the Fairness Tax which, as highlighted by Pr. Dassesse, is a compulsory assessment. There is no reason why the corporate tax base of the non-resident company could be assessed where it is computed according to foreign accounting rules whereas the Fairness Tax, which is nothing more than an additional tax along the traditional corporation tax, could not.

b) The proportion between the total amount of dividends distributed and the total accounting/taxable result of the company

Pr. Marc Dassesse also claimed that a non-resident company is less favourably treated than a resident company regarding the assessment of untaxed distributed profit (first step of the calculation of the Fairness Tax).

The Fairness Tax is meant to be due by a resident company only to the extent that the amount of distributed profits are deemed excessive in comparison with the final taxable result as a consequence of the NID and the carry-forward of tax losses. Pr.

Dassesse argued that a consequence of the limited definition of "distributed dividends" applied to non-residents is that any dividend distributed by the non-resident company, however small it is, is deemed excessive and triggers a liability to the Fairness Tax for its Belgian branch, which constitutes a discrimination incompatible with Article 49 TFEU[82]. Indeed, the part of the dividends distributed by the head office corresponding to the share of the Belgian accounting result in the total accounting result is automatically taken into account to compute the amount of untaxed distributed profits[83].

Although a clear understanding of the Fairness Tax is still far from certain, it seems however wrong to consider that any distribution would trigger the application of the Fairness Tax. The first step of the calculation of the Fairness Tax base is still to be applied but taking into account other data.

Instead of calculating the difference between the amount of gross dividends distributed by a single entity (a resident company) and its final taxable result, the Fairness Tax of a non-resident company will be based on the difference between the part of the gross dividends distributed by the head office of the Belgian branch which "corresponds to the positive share of the accounting result of the Belgian establishment in the total accounting result of the company"[84] and the corporate tax base of the non-resident company in Belgium according to Belgian tax law (and possibly to the relevant double tax conventions, Articles 5 and 7).

Thus it is also an "excessive" distribution of profits which will trigger the application of the Fairness Tax. Moreover, the adjustment of the calculation for Belgian branches of foreign companies should reflect the actual proportion between the dividends distributed by the non-resident company and its overall accounting result.

One means to remove any doubt regarding a potential difference of treatment would be for the Belgian tax authorities to clarify that if the total taxable result exceeds the amount of gross dividends distributed by the non-resident company, no Fairness Tax will be due in Belgium.

Pr. Dassesse also referred to the ECJ decision in the landmark case *Avoir fiscal* (C-270/83)[85] to argue that a difference of treatment between a non-resident

82 *Ibidem.*

83 Marc Dassesse, *op. cit.*, p. 5.

84 Bob Michel and Pieter Van Den Berghe, *op. cit.,* p. 225.

85 ECJ, 24 Jan. 1986, C-270/83, *Commission of the European Communities v French Republic ('Avoir fiscal')*, [1986] ECR I-273.

company with a subsidiary in another Member State and a non-resident company with a branch in another Member State could not be removed by the fact that non-resident companies are "at liberty to establish themselves by setting up a subsidiary in order to have the benefit of [the most favourable tax treatment]"[86][87]. If that principle from *Avoir fiscal* is not called into question here, we do not see how it is relevant as there does not seem to be any difference of treatment between a subsidiary and a branch in the application of the Fairness Tax, as explained above. Regarding the choice left to a Belgian subsidiary to "abstain from distributing dividends out of Belgian profits" in order to avoid the Fairness Tax as opposed to a Belgian branch for which the decision of the head office to make distributions is beyond its reach, the website of the American Chamber of Commerce in Belgium claimed that it amounted to a discrimination under EU law[88].

This statement failed to understand how the comparator works in EU direct tax cases from a host State Member perspective in order to ascertain the existence of potential discriminations. The comparison that has to be made is not a comparison between a Belgian subsidiary and a Belgian branch, but between a Belgian subsidiary and the non-resident company itself, which chose to exercise its freedom of establishment through the setting-up of a branch in Belgium[89]. In that respect, the non-resident company is as able to choose not to pay out any dividends to its shareholders (or at least not any excessive amount) as a Belgian subsidiary and is therefore not less favourably treated in that regard.

2) *Parent-Subsidiary Directive, Article 5*

This section examines to which extent the introduction of the Fairness Tax may have put Belgium in breach of its obligations under secondary EU law. Indeed, it seems that the Fairness Tax may amount to a hidden withholding tax and therefore not comply with the Directive 2011/96/EU, according to which Member States of subsidiaries are obliged to remove any withholding tax on distributions of profits leaving the country towards another Member State[90]. The subsequent section will carry out the converse analysis regarding Belgium as the Member State of parent company.

86 *Ibid.*, §22.

87 Marc Dassesse, *op. cit.*, p. 5.

88 'Fairness Tax' *American Chamber of Commerce in Belgium :* <http://www.amcham.be/policy/corporate-taxation/fairness-tax> accessed 5Oct 2014.

89 Tom O'Shea, *op. cit.*, p. 121.

90 Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (recast) ('Parent-Subsidiary Directive') [2011] OJ L345/8.

With a view to preventing legal double taxation, Article 5 of the Parent-Subsidiary Directive provides that "profits, which a subsidiary distributes to its parent company shall be exempt from withholding tax".

In order to prevent the introduction of unlawful withholding taxes, one needs to define precisely the term "withholding tax". The Directive does not provide for any useful definition. It only explains what it does not cover, i.e. "an advance payment or prepayment of corporation tax to the Member State of the subsidiary which is made in connection with a distribution of profits to its parent company"[91]. Article 7 goes on, providing that the "Directive shall not affect the application of domestic or agreement-based provisions designed to eliminate or lessen economic double taxation of dividends, in particular provisions relating to the payment of tax credits to the recipients of dividends"[92].

The Fairness Tax does not fall into the first of these two categories, as the corporate tax will be due irrespective of the amount of the Fairness Tax. The second exception is also out of scope here as the Fairness Tax is far from "eliminating or lessening economic double taxation of dividends".

As no such definition is provided for in the Directive, it is for the ECJ to give an autonomous definition of the concept of "withholding tax" under EU law, irrespective of what it may cover under national law[93], in order to "ensure uniform application amongst the 28 Member States"[94]. Otherwise, it would be easy for the Member States to circumvent the intention of EU instruments by shaping their obligations under EU law in light of their national law, which would undermine the principle of primacy of EU law[95].

Nonetheless, the interpretation of the Court on the matter is not straightforward. The *Athinaïki Zythopoiia* (C-294/99)[96] case, which seems to move away from a strict legal interpretation of the term "withholding tax", is often referred to in order to support the idea according to which the Fairness Tax amounts to a forbidden levy under the Parent-Subsidiary Directive. However, this judgment

91 Parent-Subsidiary Directive, art. 7(1).

92 Parent-Subsidiary Directive, art. 7(2).

93 ECJ, 8 June 2000, C-375/98, *Ministério Público et Fazenda Pública contre Epson Europe BV ('Epson'),* [2000] ECR I-4263, §45.

94 Bob Michel and Pieter Van Den Berghe, *op. cit.,* p. 232.

95 ECJ, 8 June 2000, C-375/98, *Ministério Público et Fazenda Pública contre Epson Europe BV ('Epson'),* Opinion of AG Cosmas, [2000] ECR I-4245, §45.

96 ECJ, 4 Oct. 2001, C-294/99, *Athinaiki Zithopiia AE v Elliniko Dimosio (Greek State) ('Athinaïki'),* [2001] ECR I-6797.

should be read in the context of the broader case law of the ECJ on this matter, which shows that the outcome of that judgment is not a clear-cut one.

a) Epson (C-375/98)[97]

Epson is the first case addressing the issue of the absence of definition of "withholding" tax in EU law. In that case, the Court examined the compatibility with Article 5 of the Directive of a Portuguese succession and donation tax in respect of transfers, without consideration, of shares in companies. The Portuguese tax was "levied, whenever profits [were] distributed, on the dividends paid by companies which have their seat in Portugal"[98] and was due by the shareholders.

The Court first recalled that the objective of the Directive was "to ensure that cooperation between companies of different Member States is not penalised as compared with cooperation between companies in the same Member State and thereby to facilitate the grouping together of companies at Community level" and that the elimination of double taxation was one means to achieve this[99]. Article 5(1) is one of the three components of the elimination of double taxation under the Parent-Subsidiary directive (no withholding tax in the Member State of subsidiary, no withholding tax in the Member State of parent company and avoidance of double taxation by the Member State of parent company).

In light of these objectives, the Court went on to state that the term 'withholding tax' was not limited to the types of national taxation listed in the Annex of the Directive[100] and set the 3 criteria that must be met for a tax levy to constitute a withholding tax[101]:

1) The chargeable event must be the payment of dividends or of any other income from shares.
2) The taxable amount must be the income from the shares.
3) The taxable person must be the holder of the shares.

In casu, given the features of the Portuguese tax, the Court ruled that it took the form of a withholding tax prohibited by the Directive, "the actual name of the tax

97 ECJ, 8 June 2000, C-375/98, *Ministério Público et Fazenda Pública contre Epson Europe BV ('Epson'),* [2000] ECR I-4263.

98 *Epson*, §6.

99 *Epson*, §20.

100 *Epson*, §22.

101 *Epson*, §23.

[being] immaterial"[102]. The Court pointed out that "the objective of the Directive [...] would be undermined if the Member States were permitted deliberately to deprive companies in other Member States of the benefit of the Directive by subjecting them to taxes having the same effect as a tax on income, even if the name given to the latter places them in the category of tax on assets"[103].

b) Athinaiki Zithopiia (C-294/99)

The subsequent case, *Athinaiki Zithopiia*, involved the Greek corporation tax, the base from which was increased by the amount of distributed profits corresponding to non-taxable profits or profits subject to lower taxation.

The reason why that case is often invoked in the Fairness Tax debate is that it is comparable to the adjustment to the Greek corporate tax base. Indeed, the distributed profits were "deemed to arise proportionally" from the untaxed or subject to lower taxation profits. Similarly, the objective of the Fairness Tax is to tax excessive distributions where companies make use of the NID or unlimitedly carry forward tax losses. Moreover, that amount is also restricted by a proportionality factor.

The main difference between the two levies challenged in *Epson* and *Athinaiki Zythopiia* lies in the taxable person criterion. Hence, the Court seems to have ignored a component of its three-fold test in the latter case, ruling in favour of the taxpayer.

In *Athinaïki Zythopiia*, the Court only referred to the chargeable event criterion and partially to the taxable amount criterion. In line with the *Epson* judgment, the chargeable event was also the payment of dividends and, although the tax base did not equal the entire amount of distributed dividends, it was "directly related to the size of the distribution" [104] (the fraction which corresponded to the untaxed and/or less taxed profits).

The Court inferred from these characteristics that it constituted a withholding tax but without requiring the levy to be due by the shareholder. Indeed, the person liable for the additional corporation tax was the distributing company and not the holder of the shares. Supporting an economic definition of withholding tax, Advocate General *Alber* claimed that the fact that the tax burden was not strictly speaking imposed on the parent company did not matter, as long as the economic

102 Christiana HJI Panayi, *European Union Corporate Tax Law* (Cambridge University Press, 2013), p. 46.

103 *Epson*, §24.

104 *Athinaïki*, §28.

effect of the tax was directed at the parent company [105]. Since the tax was "retained, and paid directly to the tax authorities, by the company making the distribution", the adjustment of the corporation tax base of the subsidiary company amounted to taxation of its parent company[106].

The argument put forward by the Greek government was that the relevant adjustment was no more than "a profits tax", the purpose of which was "to ensure that all corporate profits carried the same corporation tax burden at the latest upon distribution, in view of the fact that the shareholder was exempt from income tax on dividends received"[107].

However, in response, the Court found that "the taxation [related] to income which [was] taxed only in the event of a distribution of dividends and up to the limit of the dividends paid" [108]. The Court relied on the fact that the subsidiary company was not allowed to set off tax losses from previous years against the taxable base of the adjustment, whereas it was possible regarding the main corporation tax base[109].

The Court broadly interpreted the notion of withholding tax, stating that "within the field of application of the Directive, tax legislation that links particular fiscal charges to a distribution of profits is prohibited if in the absence of the distribution those fiscal charges would not arise"[110]. That conclusion of the Court in favour of the taxpayer appeared to follow the Advocate General Opinion. Therefore, it was believed that the third criterion of the *Epson* test was overridden in this case, emphasising the economic features of a withholding tax.

Nevertheless, the Court seemed to have reconsidered his line of thought in the subsequent cases *Océ van der Grinten* and *FII Group Litigation*, moving its reasoning back to a full implementation of the three-fold test. The criteria at issue in these cases were however not the criterion of the taxable person (the taxpayer involved being the company receiving the dividends), so that it was only in the *Burda* case that the Court had the chance to provide for further guidelines on the third criterion.

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105 ECJ, 4 Oct. 2001, C-294/99, *Athinaiki Zithopiia AE v Elliniko Dimosio (Greek State)*, Opinion of AG Alber, [2001] ECR I-6799, §32.

106 *Ibidem.*

107 Ben J.M. Terra and Peter J. *Wattel, European Tax Law* (6th edn, Kluwer Law International 2012), p. 638.

108 *Athinaïki*, §29.

109 *Athinaïki*, §29.

110 *Athinaïki*, AGO, §27.

c) *Océ van der Grinten* (C-58/01) [111] and *FII GLO* (C-446/04)[112]

In *Océ van der Grinten*, the Court was dealing with a 5% charge levied upon distribution of dividends. Two parts of that levy were to be distinguished. The part corresponding to the actual amount of dividends distributed was considered as a withholding tax prohibited under the Directive but was ultimately allowed under Article 7(2) of the Directive as being an agreement-based provision designed to mitigate economic double taxation[113]. On the other hand, the part corresponding to the amount of tax credit attributed to the foreign parent companies as a result of the UK-Netherlands DTC in relation with the advance corporation tax paid by a UK subsidiary did not amount to a withholding tax, considered by the Court as a tax refund instead of a profit distribution[114].

The Court used the three criteria that emerged from the *Epson* case to come to these two conclusions[115]. The part of the 5% charge which was imposed on the amount of tax credit did not meet the criterion of the taxable amount, required to be the income of the shares. Interestingly though, the Court also referred to the *Athinaiki Zithoppia* case, thereby implying that its caselaw was consistent. However, as explained above, the two paragraphs (28 and 29) referred to were confined to only two criteria out of three.

The *FII 1* case related to the now abolished UK advance corporation tax (ACT). One of the questions raised in front of the ECJ concerned "the ACT which a company receiving foreign-sourced dividends must pay on a subsequent distribution by way of dividend"[116] and its possible qualification as a withholding tax.

"The British parent argued that the ACT amounted to a secondary withholding tax at parent company level, prohibited by Article 6 of the Directive"[117]. Relying on the *Epson* test[118], the Court concluded however that the chargeable event for the

111 ECJ, 25 Sept. 2003, C-58/01, *Océ Van der Grinten NV contre Commissioners of Inland Revenue ('Océ van der Grinten')*, [2003] ECR I-9809.

112 ECJ, 12 Dec. 2006, C-446/04, *Test Claimants in the FII Group Litigation v Commissioners of Inland Revenue ('FII GLO')*, [2006] ECR I- 11753.

113 *Océ van der Grinten*, §87-88.

114 Ben J.M. Terra and Peter J. *Wattel, op. cit.*, p. 639.

115 *Océ van der Grinten*, §47.

116 *FII GLO*, §111.

117 Ben J.M. Terra and Peter J. Wattel, *op. cit.*, p. 639.

118 *FII GLO*, §109.

ACT was "not the receipt of those dividends but the payment of those dividends to its own shareholders"[119] and that therefore it did not amount to a withholding tax.

c) Burda (C-284/06)[120]

Burda is the first case since *Athinaiki Zithopiia* to address the third condition laid down in *Epson*, i.e. the holder of the shares as the taxable person. That case involved a cross border distribution of dividends by a German company (*Burda*) to its Dutch parent company. Following a tax audit that took place after the distribution, the German subsidiary suffered an increase of its corporation tax as a result of an adjustment of its profits available for distribution operated by the German tax authorities.

National tax system at hand

It is of tremendous importance to have a good understanding of the law applicable at the time in Germany in order to analyse properly the reasoning of the Court in this case. The Advocate General Opinion appeared to be very helpful in that regard.

The set of rules challenged in front of the ECJ by the subsidiary company was part of the then German imputation system. Companies liable to corporation tax in Germany are ordinarily subject to a rate of 45%[121]. When distributing dividends though, a 30% tax on distribution was levied on the profits distributed, replacing the corporation tax strictly speaking[122]. In other words, the German corporation tax was actually divided into a tax on retentions (45%) and a tax on distribution (30%), while certain profits were not subject to corporation tax. When distributing dividends, a company would thus on one hand pay a 30% tax on distribution, and on the other hand pay a 45% retention tax on the remainder of the profits subject to tax.

These rules were designed to match the corporation tax paid by the distributing company and the tax credit granted to shareholders[123]. Correspondingly, the

119 *FII GLO*, §110.

120 ECJ, 26 June 2008, C-284/06, *Finanzamt Hamburg-Am Tierpark v Burda GmbH ('Burda')*, [2008] ECR I-4571.

121 *Burda*, §9.

122 *Burda*, §10.

123 Ioannis F. Stavropoulos, 'The EC Parent-Subsidiary Directive and the Decision of the European Court of Justice in Burda' (2009) 49 No 3, European Taxation IBFD, p. 153.

corporation tax of the German distributing company was reduced or increased depending on which part of the capital and reserves was used to pay the dividends:

- the 45% corporation tax was reduced to 30% where the company was distributing profits out of the "taxed equity basket"[124] (income subject to the full rate of corporation tax)[125],
- and, conversely, it was increased from 0 to 30% where the profits were paid out of the "untaxed equity basket" [126] (additions to assets not subject to corporation tax) to make sure that no tax credit was granted to shareholders in cases where the distribution of profits was made out of "tax-free income"[127].

In the facts of *Burda*, the distribution made by the German subsidiary was partly deemed to have been paid out of the untaxed equity basket, even though it had not[128]. Alleging that "*Burda* had distributed profits in an amount greater than the taxable income", the German tax authorities "reduced the various available capital and reserve items subject to corporation tax at the full rate" and "set off the distributions which, after reduction, were no longer covered by the taxed available capital and reserves, against the capital and reserves" not subject to corporation tax[129]. It is "that set-off [which] gave rise to increases in corporation tax"[130]. Indeed, part of the profits subject to corporation tax the rate of which was reduced from 45% to 30% was subject to a 45% rate of tax again.

It is worth pointing out that the amount of profits distributed was taxed at a rate of 30% under the tax on distribution in either case. From an accounting point of view though, part of the profits was not paid out of the taxed equity basket but from the untaxed equity basket. Yet, the amount of tax payable remained the same. The increase in corporation tax stemmed from the fact that part of the taxed equity basket was no longer deemed to be distributed to shareholders and therefore was taxed at a rate of 45% under the tax on retention.

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124 Christiana HJI Panayi, *op. cit.*, p. 48.

125 ECJ, 26 June 2008, C-284/06, *Finanzamt Hamburg-Am Tierpark v Burda GmbH ('Burda')*, Opinion of AG Mengozzi, [2008] ECR I-4571, §60.

126 Christiana HJI Panayi, *op. cit.*, p. 48.

127 Ioannis F. Stavropoulos, *op. cit.*, p. 153.

128 Christiana HJI Panayi, *op. cit.*, p. 48.

129 *Burda*, §27.

130 *Burda*, §28.

Provisions under scrutiny

Attention needs to be drawn to the question as to which part of the German tax system exactly was challenged under Article 5(1) of the Parent-Subsidiary Directive. Reformulated unclearly by the ECJ, the question referred to under the preliminary ruling consists of asking "whether a provision of national law which, in relation to cases where profits are distributed by a subsidiary to its parent company, provides for the taxation of income and asset increases of the subsidiary which would not have been taxed if they had remained with the subsidiary and had not been distributed to the parent company constitutes withholding tax [...]"[131].

The Advocate General notes however that the German court is only questioning the compatibility with Article 5(1) of the Parent-Subsidiary Directive of the 30% tax on distributions in respect of the additions to assets not subject to corporation tax (the untaxed equity basket)[132]. Hence, the preliminary ruling is not dealing with the question "as to whether the initial tax on distributions, namely that paid before the correction by the tax authorities, is also a withholding tax within the meaning of that provision" [133].

By contrast, stating that it is the "tax uplift calculated on the dividends"[134] which is challenged in front of the Court is rather misleading, as in reality it is the accounting correction that seems to be targeted here.

Similarity with the Athinaïki case

Unsurprisingly, the taxpayer, joined by the Commission, relied on the Greek case *Athinaïki* to put forward the argument according to which, despite the absence strictly speaking of the third criterion of the *Epson* test, the German tax at issue fell within the scope of Article 5 of the Directive given its economic resemblance to a withholding tax.

Indeed, that "German equalization tax at company level on profit distributions [was] similar to the Greek profits distribution tax"[135] (and thereby to the Fairness Tax) in that a tax was levied upon distribution of profits which, if they had remained with the company, would arguably not have been taxed.

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131 *Burda*, §50.

132 *Burda*, AGO, §49

133 *Burda*, AGO, §49

134 Christiana HJI Panayi, *op. cit.*, p. 47-48.

135 Ben J.M. Terra and Peter J. Wattel, *op. cit.*, p. 640.

However, the Court explicitly held that the three criteria of the *Epson* test "must be *cumulatively* fulfilled" and subsequently ruled that the tax levy did not amount to a withholding tax, the taxable person being the distributing company [136]. Thereby, the Court swept aside the argument based on its previous jurisprudence, and along with it the "approach based on economic assessments"[137], clarifying that the outcome of the *Athinaïki* case was not able to undermine its conclusion in the *Burda* case.

The Court specified that it resulted from the "subsequent"[138] case-law (referring to *Océ van der Grinten* and *FII1*) that the criterion regarding the taxable person must still be fulfilled and that, otherwise, a levy would not constitute a breach of EU law. Certain scholars inferred from the word 'subsequent' that the Court "in guarded terms admitted having made a mistake in *Athinaïki Zythopiia*"[139]. The present study however argues that the outcome of the *Burda* case is not necessarily black and white and that some cohesion in the jurisprudence of the Court may still be found.

Distinction with the Athinaïki case

Heading to the same conclusion as the Court regarding the application of Article 5(1) of the Directive, Advocate General Mengozzi distinguished between the facts in *Athinaïki* and in *Burda*, arguing that in the first case it was clearly the dividends which were taxed whereas in the latter it was merely the profits of the subsidiary company which were taxed as a result of an error of the subsidiary in the amount of dividend distributed[140].

In that regard, the Advocate General first recalled that the Parent-Subsidiary Directive is intended to eliminate multiple source of double taxation, encompassing economic and legal double taxation[141]. Article 5 of the Directive is exclusively dealing with legal double taxation in that it prohibits withholding taxes on distributed profits in the subsidiary Member State[142]; it is therefore not tackling economic double taxation which consists of taxing "the same income in the hands of the same taxpayer"[143].

136 *Burda*, §§54-56.

137 *Burda*, §57.

138 *Burda*, §61.

139 Terra and Watter, p. 640.

140 *Burda*, AGO, §§70-73.

141 *Burda*, AGO, §50 and 52.

142 *Burda*, AGO, §53.

143 *Burda*, AGO, §52.

This is confirmed by Article 7(1) of the Directive which "states that the term [withholding tax] does not cover an advance payment or prepayment (précompte) of corporation tax to the Member State where the subsidiary is situated, when it is made in connection with a distribution of profits to its parent company"[144]. "In other words, [...] the prohibition [of Article 5(1)] does not extend to the payment by the subsidiary of corporation tax on income generated by its economic activity, even if that tax is deducted at source and it is paid in conjunction with the distribution of profits."[145] This explains the basis for the threefold test in the *Epson* case[146], and why its third condition must imperatively be fulfilled.

It will then be for the Parent Member State to eliminate the economic double taxation "either [by refraining] from taxing such profits or [taxing] them while authorising the parent company to deduct from the amount of tax due the fraction of the tax paid by the subsidiary which relates to those profits"[147].

In the light of the above, the Advocate General argued that if the "charge, after correction" by the German tax authorities should be deemed to constitute a withholding tax, so should the initial 30% tax on distribution without any correction[148], which cannot be true as it is part of the corporation tax of the subsidiary[149].

In few words, the Court timidly followed that reasoning, pointing out that "*Burda* is liable to corporation tax when it distributes profits"[150], before stating that "the holders of the shares are *Burda* International and RCS"[151] and that, as a consequence, "the third condition for the existence of a withholding tax is lacking"[152].

To sum up, the AG tried to highlight the fact that the ECJ did not back off from its previous jurisprudence by demonstrating that the cases in *Athinaïki* and *Burda*

144 *Burda*, AGO, §54.

145 *Burda*, AGO, §55.

146 *Burda*, AGO, §57.

147 *Burda*, AGO, §56.

148 *Burda*, AGO, §59.

149 The Advocate General relied on a comparison with the old UK Advance Corporate Tax which was released from any incompatibility with the Directive at issue (FII GLO, *op. cit.*, §88).

150 *Burda*, §55.

151 *Ibidem.*

152 *Burda*, §56.

were not comparable: in *Burda*, the Court was dealing with a tax which had the characteristics of a corporation tax, whereas in *Athinaïki* the tax at issue would not have been charged if the subsidiary had not proceeded to any distribution of dividends and therefore was considered as a hidden withholding tax.

Indeed, in Burda, the profits of the subsidiary company were originally taxed either at a rate of 30% if distributed or at a rate of 45% if retained with the company. Hence, the profits would have been taxed in either scenario. The income taxed at a rate of 30% (even after the correction made by the tax authorities) was therefore the income "generated by Burda's economic activity in Germany" and not the income which was "taxed only when dividends [were] paid"[153].

Moreover, the correction made by the tax authorities was merely an accounting one and did not change the "overall tax charge borne" by the company on the amount of profits distributed to its shareholders[154].

Remarks

The distinction between the *Burda* and *Athinaïki* cases is however more tenuous than it seems. The taxpayer should probably have pushed the national Court to question the ECJ differently in order to challenge the increase of the tax on retentions which was charged on profits ordinarily untaxed as a result of what was considered by the German tax authorities as an excessive distribution.

Although the tax on retentions is also strictly speaking part of the corporation tax, the increase which followed the tax audit conducted by the tax authorities only stemmed from what was considered by the German tax authorities as an excessive distribution. In our opinion, an argument based on paragraph 27 of the *Athinaïki* case would have made it difficult for the Court not to apply a more economic assessment of the relevant tax uplift, which was not merely "a circumstance unrelated" [155] to the correction at issue as argued by the Advocate General.

The tax uplift, which, in the absence of the distribution would not have arisen, could therefore be considered as a withholding tax.

A factor which might have been given some weight by the Court in its decision not to follow an economic approach was the fact that the "the correction [...] was made after payment of the dividends to the shareholders"[156] in the context of a tax

153 *Burda*, AGO, §60.

154 *Burda*, AGO, §73.

155 *Burda*, AGO, §75.

156 *Burda*, AGO, §64.

audit. As the shareholders had already benefited from the distribution, it did not a fortiori affect the amount of profits distributed[157].

Finally, one may ask why the Court in *Burda* did not investigate the question as to whether or not the subsidiary was able to set off tax losses carried back or other tax deductions against the part of the tax challenged in front of the Court. That might have helped comparing the facts of *Burda* and *Athinaïki*, where such a possibility did not exist.

d) Ferrero (C-338/08 and C-339/08)[158]

The *Burda* judgment was followed by a judgment given in the joined cases *Ferrero* and *General Beverage*, dealing this time with the second criterion of the *Epson* test (taxable income) in the context of the refund to Dutch parent companies of the Italian adjustment surtax charged on Italian subsidiaries upon an excessive distribution of dividends[159].

The ratio legis of the Italian surtax is similar to the one which prevailed regarding the Greek and German distribution taxes in *Athinaïki Zythopiia* and in *Burda*, i.e. ensuring that where a tax credit is granted to shareholders, it actually corresponds to a tax effectively paid by the distributing company[160]. The parent company established in the Netherlands could, under the Double Tax Convention concluded between Italy and the Netherlands, obtain a refund of that surtax but that refund was subject to a 5% withholding tax, since it was included in the term "dividends"[161]. It was not the adjustment surtax itself which was challenged in front of the Court but precisely the 5% withholding tax charged on its refund[162].

The central question of the judgment was whether the refund of the adjustment surtax could be categorised as an income from share in order to meet the second criterion of the test[163].

157 Ioannis F. Stavropoulos, *op. cit.*, p. 153.

158 ECJ, 24 June 2010, C-338/08 and C-339/08, *P. Ferrero e C. SpA v Agenzia delle Entrate - Ufficio di Alba and General Beverage Europe BV v Agenzia delle Entrate - Ufficio di Torino 1 ('Ferrero')*, [2010] ECR I-5743.

159 *Ferrero*, §9.

160 *Ferrero*, §29.

161 *Ferrero*, §§12-13.

162 *Ferrero*, §20.

163 *Ferrro*, §27.

The Court noted that the answer to this question requires to know the nature of the underlying tax, i.e. the adjustment surtax[164]. This is where it gets interesting for our understanding of the *Burda* case. Citing *Burda*, the Court held that the Italian surtax could not "be regarded as a withholding tax [...] since the taxable person [was] not the holder of the shares but the company making the distribution"[165]. Therefore, the surtax was considered as "an additional tax on corporate profits borne by the company making the distribution, which the Directive does not preclude"[166].

That quick assessment by the Court seems to suggest that the interpretation of the third criteria of the *Epson* test is rather straight forward since *Burda* and, that in any cases, where the parent company is not legally the taxable person, there cannot be any withholding tax, inferring that there is no room for any economic assessment of the tax levy.

The Court held that, in cases where the refund was effectively deducted from the amount of surtax due by the subsidiary company[167], it was not a distribution of profits but a transfer of part of the subsidiary's corporation tax[168]. Therefore, the 5% withholding tax could not be regarded as a withholding tax on profits prohibited by the Parent-Subsidiary Directive.

d) Application to the Fairness Tax

It follows from the above development that the jurisprudence of the ECJ on the matter is not black and white. Given the resemblance of the Fairness Tax to the levy at issue in *Athinaïki*, it could be argued (and it has been) that the same reasoning should be held regarding the Belgian tax and that it should be deemed to constitute a prohibited withholding tax.

Indeed, the two first criteria of the *Epson* test (chargeable event and taxable income) seem to be met. Furthermore, although the taxable person is the distributing company, the similar features of the two levies could possibly lead to an economic assessment of the withholding nature of the Fairness Tax.

However, the analysis of the subsequent jurisprudence of the Court showed that it is unclear as to whether or not there is still room in EU law for an economic

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164 *Ferrero*, §28.

165 *Ferrero*, §34.

166 *Ferrero*, §35.

167 *Ferrero*, §38.

168 *Ferrero*, §36.

definition of "withholding tax". The distinction of the facts in the *Athinaïki* and *Burda* cases slightly helps to understand what was wrongly seen as a reversal of the Court's jurisprudence in the *Burda* case. However, it all comes down to tiny details so that it is rather difficult to anticipate the conclusion of the ECJ if a question were to be referred to her regarding the effects of the Fairness Tax.

Moreover, in the later case *Ferrero*, the Court seems to have built up on *Burda* to state that there will not be any such economic assessment anymore in the future, which casts doubt on a possible ruling of the Court in favour of the taxpayer.

3) Parent-Subsidiary Directive, Article 4

Article 4 of the Parent-Subsidiary Directive also provides for the fiscal neutrality of cross-border dividends[169] but at the level of the parent company. It seeks to eliminate economic double taxation of profits distributed from a subsidiary established in one Member State to its parent company established in another Member State.

Therefore, Article 4(1) sets the obligation for the Member State of parent company to "refrain from taxing such profits" or to "tax such profits while authorising the parent company […] to deduct from the amount of tax due that fraction of the corporation tax related to those profits and paid by the subsidiary […] up to the limit of the amount of the corresponding tax due". In other words, Article 4 provides for the elimination of economic double taxation by the Member State of parent company through either an exemption system or an imputation/credit system, with an exception in the event of the subsidiary's liquidation.

Belgium established a participation exemption system[170] according to which 95% of the cross-border dividends received are exempt from tax [171], provided that some quantitative[172] and qualitative[173] conditions are met.

169 Renaud Hendricé, *op. cit.*, p. 11.

170 CIR 1992, art. 202(1)1°.

Whole system: Art. 202-205 CIR 1992 (see René Offermanns and Bob Michel, *"Belgium – Corporate Taxation",* sec. 6, Country Analyses IBFD <https://www.ibfd.org/IBFD-Tax-Portal/Country-Surveys> accessed 6 August 2014).

171 CIR 1992, art. 204. The 5% of the dividends which are not exempt from tax represent the management costs of the holding, according to art. 4(3) of the Directive.

172 CIR 1992, art. 202(2) 1° and 2°: the parent company must hold a minimum participation of 10% or an investment value of at least EUR 2.5 million in the capital of its subsidiary. Moreover, the parent company must have held that participation in full legal ownership for one uninterrupted year.

Some scholars have called into question the compatibility of the Fairness Tax with this set of rules[174] regarding certain companies. Since Belgium decided to follow the EU law provisions on the matter for domestic situations[175], the same reasoning may apply to internal distributions of dividends.

An article written by Renaud Hendricé[176] explains very clearly to what extent the Fairness Tax may treat less favourably mixed holding companies when compared to pure operating companies.

The tables below compare two companies at the end of a given fiscal year. Company A is a mixed holding company, i.e. whose range of activities encompasses business activities as well as holding activities. Company B is a pure operating company. They both have the same operating income and distribute all the profits of the year to their shareholders. They both benefited from the same notional interest deduction and carry-forward of losses.

The only difference lies in the fact that, since Company A has holding activities along with operating activities, it received dividends from its subsidiary(ies). These dividends are redistributed to the shareholders as well.

As Company A and Company B are both considered to have distributed an excessive amount of dividends compared to their final tax result, they are both liable to the Fairness Tax. However, Company A's taxable base under the Fairness Tax will be broader as: 1) the amount of dividends that have been distributed is much higher, 2) accordingly the result of the first operation (dividends distributed minus final tax base) is higher as well, and 3) the proportionality factor is lower.

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173 CIR 1992, art. 203 enumerates 5 situations where the participation exemption will not be granted. These exceptions are mainly related to the level of taxation of the subsidiary company.

174 Among others : Renaud Hendricé, *op. cit.*; Bob Michel and Pieter Van Den Berghe, *op. cit.*

175 René Offermanns and Bob Michel, *"Belgium – Corporate Taxation",* sec. 6, Country Analyses IBFD: <https://www.ibfd.org/IBFD-Tax-Portal/Country-Surveys> accessed 6 August 2014.

176 Renaud Hendricé, *op. cit.*, p. 11-12.

Company A – Mixed holding company	
Operating profit	1.000
Dividends received	500
Dividends distributed	1.500
Tax base	
Tax base after first operation	1.500
Participation exemption	- 475
Notional interests / Losses carried forward	- 700
Final tax base	325
Fairness Tax	
Distributed dividends (1500) – Final tax base (325)	1.175
Proportionality factor (700/1.500)	46,6%
Fairness Tax base (1175 x 46,6%)	548,25
Fairness Tax rate of 5,15%	28,23

Company B – Operating company	
Operating profit	1.000
Dividends distributed	1.000
Base imposable	
Tax base after first operation	1.000
Notional interests / Losses carried forward	- 700
Final tax base	300
Fairness Tax	
Distributed dividends (1000) – Final tax base (300)	700
Proportionality factor (700/1.000)	70%
Fairness Tax base (700 x 70%)	490
Fairness Tax rate of 5,15%	4,79

As a consequence, mixed holding companies, despite an identical operating profit, will bear a significantly higher Fairness Tax than companies with no holding activities which seems to go against the neutrality principle pursued under the Parent-Subsidiary Directive[177].

177 Bob Michel and Pieter Van Den Berghe, *op. cit.*, p. 231.

According to Bob Michel and Pieter Van Berghe, given the hypothetical nature of these assertions[178], it does not seem very likely that the Commission will want to start an infringement procedure against Belgium on the grounds of Article 4 of the Parent-Subsidiary Directive[179]. If, however, the Commission were to decide to start one, it would rather be based on Article 5 of the Directive, and possibly on the freedom of establishment.

Renaud Hendricé[180] also demonstrated that the same consequence applies for mixed holding companies with other income from shares, i.e. capital gains. Although capital gains do not fall under the scope of the parent-subsidiary directive, it is worth a short development.

In Belgium, capital gains from shares held for at least a year are exempt from tax[181] (or almost exempt regarding big corporations, for which a 0,4% charge applies since 2013[182]). If the shares are held for less than a year though, it results in a 25% charge (or the full 33,99% corporation tax rate if the qualitative conditions required for the participation exemption system are not met)[183]. However, in cases where such companies distribute the amount of exempt (or almost exempt) capital gains and set off notional interests and previous losses against their profits, they will end up paying a higher Fairness Tax as these incomes are not part of the final taxable result of the company. The reason is that it involves a decrease of the amount of excessive dividends the first step of the computation of the Fairness Tax base leads to and of the denominator of the proportionality factor of the third step.

According to Christian Chérui[184], this could not have been the intention of the legislature. Yet, this would not only have the effect of discouraging companies to use notional interests deduction and carry-forward of losses, but it would also reduce the attractiveness for the Belgian holding regime. This idea was again

178 ECJ, 17 June 2010, C-105/08, *European Commission v Portuguese Republic ('Commission v Portugal'),* [2010] ECR I-5331.

179 Bob Michel and Pieter Van Den Berghe, *op. cit.,* p. 231.

180 Renaud Hendricé, *op. cit.*

181 CIR 1992, art. 192(1), §1.

182 CIR 1992, art. 217, §1, 3°.

183 CIR 1992, art. 217, §1, 2°.

184 Jean-Paul Bombaerts, 'La "Fairness Tax": mauvaise réponse au shopping fiscal' *L'Echo* (Brussels, 2 August 2013) : <http://www.lecho.be/actualite/economie_politique_belgique/La_Fairness_tax_mauvaise_reponse_au_shopping_fiscal.9383980-3154.art> accessed 6 August 2014.

recently supported by Olivier Hermand and Patrice Delacroix, who claimed that the Fairness Tax was not meant to target the latter regime[185].

It seems that this criticism has been taken into account by the tax authorities, which clarified that misunderstanding in the administrative circular released in April 2014. Capital gains which are partly exempt from tax (i.e. subject to the 0,4% tax rate) are not to be taken into account when determining the denominator of the proportionality factor in the third step of the computation of the Fairness Tax base[186].

Nonetheless, a problem may still remain in cases where income from capital gains are distributed in further years[187].

Part III. Compatibility of the Fairness Tax with Tax Treaties

1) OECD Model Tax Convention, Article 2

Michel and Van Den Berghe correctly pointed out that, prior to the question as to whether or not the new Fairness Tax is compatible with provisions included in tax treaties concluded by Belgium, one needs to ask if that levy actually "falls within the material scope of tax treaties"[188].

Since Belgian Double Tax Conventions (DTC) usually follow the OECD Model, the answer to that question is to be found in Article 2, which is dealing with the 'taxed covered' by the Model convention. As expressed by the name of the Model as well, it applies to "taxes on income and on capital"[189]. That includes "all taxes imposed on total income, on total capital, or on elements of income or of capital"[190]. The article goes on by illustrating which kind of taxes that may encompass, i.e. "taxes on gains from the alienation of movable or immovable

185 Olivier Hermand and Patrice Delacroix, 'Une clarification bienvenue de l'administration fiscale à propos de la Fairness tax et des plus values sur action' *L'Echo* (Brussels, 10 September 2014) : <http://www.lecho.be/agora/analyse/Une_clarification_bienvenue_de_l_administration_fiscale_a_propos_de_la_Fairness_tax_et_des_plus_values_sur_actions.9543199-2338.art> accessed 2 October 2014.

186 Circulaire AGFisc n°13/2014 (n°Ci.RH.421/630.788) du 3 avril 2014, *op. cit.*, §17.

187 Olivier Hermand and Patrice Delacroix, *op. cit.*

188 Bob Michel and Pieter Van Den Berghe, *op. cit.,* p. 233.

189 OECD Model, art. 2(1).

190 OECD Model, art. 2(2).

property, taxes on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation"[191].

Then, both contracting States are invited to list their respective taxes for the purpose of the application of the Convention[192]. The Belgian Corporate Income Tax is obviously part of that list in tax treaties signed by Belgium whereas the Fairness Tax, recently added to the Belgian tax system, is not.

Although the words "in particular" indicate that the list is not exhaustive[193], it seems to serve only for changes to domestic law which may occur before the signing of the treaty and not after[194]. Indeed, the taxes listed in this article are part of the balance sought by the contracting parties when agreeing on a coherent set of rules based on the principle of reciprocity. That balance would be undermined if the contracting states had the discretion to render any new taxes subject to the tax treaty.

By contrast, Article 2(4) addresses the problem of the subsequent introduction of new levies and provides that "the Convention shall apply also to any identical or substantially similar taxes that are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes"[195]. As explained by Patricia Brandstetter, "Article 2(4) preserves treaty benefits in case of changes perceived to be immaterial to the bilateral consensus when the treaty was signed"[196].

However, the Fairness Tax does not seem to be merely a minor change. Although it is contained in the Belgian Income Tax Code (CIR 1992) and applies to companies subject to corporation tax in Belgium, the Fairness Tax is "a separate assessment", meaning that "it applies in addition to the ordinary corporate tax liability and cannot be sheltered with tax deductions, such as business expenses, CFTL, a dividend received deduction, an investment deduction, etc"[197]. Therefore, it seems hardly identical to Belgian corporation tax.

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191 OECD Model, art. 2(2).

192 OECD Model, art. 2(3).

193 OECD, Commentary, §6.

194 Michael Lang, article 2, p. 220.

195 Model OECD, art. 2(4)

196 Patricia Brandstetter, *"Taxes Covered": A Study of Article 2 of the OECD Model Tax* Conventions (IBFD, 2011), p. 58.

197 Bob Michel and Pieter Van Den Berghe, *op. cit.,* p. 226.

Regarding "substantially similar taxes", in the absence of explanations in the Model and Commentaries on what exactly that means[198], the doctrine and the case law may prove useful.

According to Brandstetter, "the substance of the taxable object is the ultimate yardstick to measure substantial similarity. […] The key constitutive elements of a tax will regularly lie with the taxable object in the broad sense of the nature of the thing, transaction or sum of money that is subject to tax, and in a narrower sense, what items are included or excluded in the assessment of the tax"[199].

The taxable object of the Fairness Tax is the share of the untaxed distributed profit that corresponds to the percentage of erosion of the corporate tax base by means of the notional interest deduction and the carry-forward of losses.

Two constitutive elements can thus be highlighted here: on the one hand the distributed profit part which is common to the corporate tax base; but on the other hand that first element is only taxed to the extent that it represents the part of it that is not taxed as a result of elements that are specifically excluded from the calculation of the corporate tax base.

According to Michael Lang, although Article 2(4) "seems to refer [only] to the taxes listed in […] Article 2(3) as a benchmark, this does not mean […] that a newly introduced tax may fall under the treaty only if a similar tax was already levied at the time the bilateral treaty was signed". He claims that Article 2(1) and (2) are still applicable and that a new levy may fall under the scope of a double tax convention as long as it is a tax on income or on capital[200].

However, theoretically, "the taxable object is profits that have been distributed after being subject to the tax on income". Thus, "the Fairness Tax is not levied either on disposal income or on capital"[201].

Contrasting the Fairness Tax to a Swedish temporary tax on profit distributions which was held not to be substantially similar to taxes on income and capital by the Swedish Supreme Administrative Court, Michel and Van Der Berghe argued that the Fairness Tax is at least "not substantially dissimilar to an income tax"[202]. The

198 Patricia Brandstetter, *op. cit.*, p. 59.

199 Patricia Brandstetter, *op. cit.*, p. 61.

200 Michael Lang, '"Taxes Covered" – What is a "Tax" according to Article 2 of the OECD Model?' (2005) 59 No 6, Bulletin for International Taxation IBFD, p. 221.

201 Bob Michel and Pieter Van Den Berghe, *op. cit.,* p. 233.

202 *Ibidem*.

most important feature identified in that regard was that the purpose of the Fairness Tax is "to serve as a correction mechanism for certain aspects of the corporate income tax"[203]. Despite the separate tax assessment and the different taxable object, the Fairness Tax might thus be subject to the Belgian treaty network.

It will be for the national courts to interpret the DTC signed by Belgium in light of the features of the Fairness Tax and ascertain the applicability of the DTC provisions.

2) OECD Model, Articles 7 and 23

Assuming that it falls within the scope of the Belgian treaty network, the Fairness Tax may be incompatible with Article 7 (along with Article 23) according to which Belgium is obliged to exempt the business profits of Belgian companies derived from their permanent establishment located in other contracting states[204].

The effects of the Fairness Tax may in certain cases go against Belgium's exemption obligation. For instance, if a company in year 1 (as of 2014) receives profits from its foreign permanent establishment, these profits will be exempt from corporate tax. Nevertheless, if these profits are not distributed in year 1 but retained in the company and subsequently distributed in year 2, the company may be liable to Fairness Tax on part of these profits, provided that the conditions for the applicability of the Fairness Tax are met. Indeed, it will increase the level of untaxed distributed profit.

Conclusion

The present study provides for a brief explanation of the functioning of the new Fairness Tax, highlighting its main features (separate tax assessment, chargeable event, tax base, scope and rate) and describing how it fits into the existing Belgian tax system. It seems to be more complex than suggested at first sight and will undoubtedly increase the administrative burden on Belgian corporate taxpayers in Belgium.

Regarding its ratio legis, the Fairness Tax was essentially designed to counteract the increasing use of the NID and of the carry-forward of losses, which

203 *Ibidem.*

204 N. Lippens, 'Fairness Tax: voor wie meer dividend uitkeert dan belasting betaalt' (2013) n°27, Fiscale Actualiteit, 2013, p. 1-5.

significantly lower certain companies' tax base (mainly large companies), and thereby to increase tax revenue and reduce Belgium's tax debt.

One may wonder if that measure is however likely to achieve the aims it pursues. Indeed, it was demonstrated that the taxpayers' behaviour might be influenced in such a way that no tax revenue would actually be collected from the Fairness Tax (companies retaining profits or relocating to other jurisdictions). That would mainly be the case for those companies that benefit the most from the targeted incentives, thereby calling into question the 'fairness' objective of the tax.

The effects of the tax are thus far from certain. Yet, Belgium will not be able to continually introduce new tax measures to respond to these changes of behaviour, or at least not without jeopardising the legal certainty of the Belgian tax system (likely to deter investors from investing in Belgium).

This short study also stresses the nebulous features of the Fairness Tax in light of Belgium's obligations under EU law and international law. To that extent, it has compiled all the concerns of many scholars and practitioners on the matter and tried to demonstrate that some of them are still grey areas.

Regarding EU law, 3 potential breaches have been identified and could be relied on in an infringement procedure and/or under a preliminary ruling: a restriction on freedom of establishment, a breach of Article 4 of the Parent-Subsidiary Directive which imposes the obligation to the Member State of parent company to refrain from taxing cross-border dividends at the level of parent company, and a breach of Article 5 of the same Directive which precludes the application of withholding taxes at subsidiary level.

While arguments based on the freedom of establishment appear to be a little bit shallow and arguments based on Article 4 of the Parent-Subsidiary too hypothetical, the question of the resemblance of the Fairness Tax with a withholding tax is crucial. The jurisprudence of the ECJ on the matter has shown some inconsistencies, so that it is hard to predict how the ECJ would rule if this question were to be referred in front of her. Although it was argued that the Court completely rejected its previous economic interpretation of the term "withholding tax", the present paper claimed that the answer is not black and white. Therefore, the fact that the Fairness Tax is due by the distributing company cannot completely exclude any incompatibility with secondary EU law.

Finally, scrutiny of the Fairness Tax in light of Articles 7 and 23 of the OECD Model Tax Convention has shown that the Fairness Tax could amount to an unlawful levy on certain business profits exempt from tax, provided the OECD Model actually applies to it.

Only the future will tell whether or not the Fairness Tax will survive these criticisms. Companies must stay alert to further developments on the matter (notification to the Commission, action on annulment in front of the Belgian Constitutional Court, various legal proceedings, and possible procedures in front of the ECJ…).