THE COMPATIBILITY OF THE BELGIAN DEDUCTION FOR RISK CAPITAL REGIME WITH EU LAW

Gauthier Cruysmans[1]

1. Introduction

Basically, tax rules can be found at three levels in the European Union ("EU") scheme: the international level, the EU level and the national level. As highlighted by Professor Tom O'Shea in the description of its Triangular Model, the overarching rule operating in such scheme is that the EU level is supreme[2]. In other words, the national law of the Member States, covered by both their domestic rules and the international agreements concluded by them, must comply with EU law[3].

EU law can currently be divided into the 'positive integration' rules and the 'negative integration' rules. The former rules represent the EU secondary legislation aimed to replace or supplement the Member States national rules. It should be point out that, currently, only a few legislative acts regarding direct taxation have been adopted at the EU level[4], which is mainly due to the unanimity requirement for the adoption of such legislation[5].

1 Gauthier Cruysmans can be contacted by email at gauthiercruysmans@yahoo.com

2 T. O'Shea, "EU Tax Regulatory Framework", *The Tax Journal*, Issue 955, 3 November 2008; T. O'SHEA, *EU Tax Law and Double Tax Conventions*, Avoir Fiscal limited, London, 2008.

3 T. O'Shea, "EU Tax Regulatory Framework", *op. cit.*, pp. 13-14 and the articles cited; ECJ, 4 July 1964, C-6/64, *Flaminio Costa contre E.N.E.L.*, [1964] ECR 01141.

4 See *e.g.* Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States, *OJ* L 225, 25/08/1990, pp. 1-5 as amended by Council Directive 2005/19/EC of 17 February 2005 amending Directive 90/434/EEC 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States, *OJ* L 58, 4.3.2005, pp. 19-26.

5 EC Treaty, art. 94 and 308 EC Treaty (Now respectively TFEU, art. 115 et 352).

The latter rules concern the principles included in the EC Treaty[6] with which the Member States have agreed to comply with when they joined the EU, *i.e.* the abolition of discrimination on grounds of nationality[7], the rights of EU citizenship[8], the rights contained in the fundamental freedoms[9] and the state aid prohibition[10]. Based on those principles, the European Court of Justice ("ECJ") decisions have had an increasing impact on the direct tax regimes of Member States, by frequently upholding that "*although* (…) *direct taxation does not as such fall within the purview of the Community, the powers retained by the Member States must nevertheless be exercises consistently with Community law*"[11]. The ECJ has indeed delivered a number of decisions which have resulted in a certain degree of tax harmonisation among the EU Member States in areas such as tax treatment of foreign workers[12], tax treatment of outbound[13]/inbound[14] dividends, withholding taxes[15], cross-border loss relief[16], CFC rules[17], exit taxes[18], transfer pricing[19], thin capitalisation rules[20] and infringements of state aid rules[21].

6 Now TFEU.

7 EC Treaty, art. 12 (Now TFEU, art. 18).

8 EC Treaty, art. 17 *et seq.* (Now TFEU, art. 20 *et seq.*).

9 EC Treaty, art. 23 *et seq* .(Now TFEU, art. 28 *et seq.*); EC Treaty, art. 39 *et seq.* (Now TFEU, art. 45 *et seq.*); EC Treaty, art. 43 *et seq.* (Now TFEU, art. 49 *et seq.*); EC Treaty, art. 49 *et seq.* (Now TFEU, art. 56 *et seq.*) and EC Treaty, art. 56 *et seq.* (Now TFEU, art. 63 *et seq.*).

10 EC Treaty, art. 87 *et seq.* (Now TFEU, art. 107 *et seq.*).

11 See *inter alia* ECJ, 14 February 1995,C-279/93, *Finanzamt Köln-Altstadt v Schumacker,* [1995] ECR I-00225, Par. 21; ECJ, 11 August 1995, C-80/94, *G. H. E. J. Wielockx v Inspecteur der Directe Belastingen,* [1995] ECR I-02493; ECJ, 14 September 1999, C-391/97, *Frans Gschwind v Finanzamt Aachen-Außenstadt,* [1999] ECR I-05451; ECJ, 26 October 1999, C-294/97, *Eurowings Luftverkehrs AG v Finanzamt Dortmund-Unna,* [1999] ECR I-07447.

12 See *inter alia Schumacker, supra,* fn n°10*;* ECJ, 12 December 2002, C-385/00, *F.W.L. de Groot v Staatssecretaris van Financiën,* [2002] ECR I-11819.

13 See *inter alia* ECJ, 12 December 2006, C-374/04, *Test Claimants in Class IV of the ACT Group Litigation v Commissioners of Inland Revenue,* [2006] ECR I-11673; ECJ, C-170/05, 14 December 2006, *Denkavit Internationaal BV and Denkavit France SARL v Ministre de l'Économie, des Finances et de l'Industrie,* [2006] ECR I-11949.

14 See *inter alia* ECJ , 28 January 1986, C-270/83, *Commission of the European Communities v French Republic ['Avoir fiscal'],* [1986] ECR 00273; ECJ, 21 September 1999, C-307/97, *Compagnie de Saint-Gobain, Zweigniederlassung Deutschland v Finanzamt Aachen-Innenstadt,* [1999] ECR I-06161.

15 See *inter alia Denkavit Internationaal, supra,* fn n°12; ECJ, 19 November 2009, C-540/07, *Commission of the European Communities v Italian Republic,* [2009].

16 See *inter alia* ECJ, 13 December 2005, C-446/03, *Marks & Spencer plc v David Halsey (Her Majesty's Inspector of Taxes),* [2005] ECR I-10837; ECJ, 25 February 2010,C-337/08, *X Holding BV v Staatssecretaris van Financiën,* [2010].

The Belgian deduction for risk capital regime, better known as the notional interest deduction regime ("NID regime"), is a perfect illustration of the impact of the EU law on the Member States tax systems for two reasons. Firstly, the NID regime, which basically aims to attract equity-financed investments to Belgium, has replaced the coordination centre regime which was successfully attacked by the EU Commission before the ECJ, under the European state aid rules[22]. Secondly, this paper demonstrates that some aspects of the NID regime itself may be questioned in terms of compatibility with EU law[23].

2. The Belgian NID Regime

2.1. Historical background – The Belgian coordination centre Regime

2.1.1. Introduction

Set up by Royal decree in 1982[24], the Belgian coordination centre regime was basically introduced by the Belgian authorities to attract multinational groups by allowing them to carry out defined auxiliary or preparatory intra-group activities (especially financial, management, accounting or

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17 See *inter alia* ECJ, 12 September 2006, C-196/04, *Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue*, [2006] ECR I-07995; ECJ, 23 April 2008, C-201/05, *The Test Claimants in the CFC and Dividend Group Litigation v Commissioners of Inland Revenue*, [2008] ECR I-02875.

18 See *inter alia* ECJ, 11 March 2004, C-9/02, *Hughes de Lasteyrie du Saillant v Ministère de l'Économie, des Finances et de l'Industrie*, [2004] ECR I-02409; ECJ, 7 September 2006 C-470/04, *N v Inspecteur van de Belastingdienst Oost/kantoor Almelo*, [2006] ECR I-07409.

19 See *inter alia* ECJ, 12 December 2002, C-324/00, *Lankhorst-Hohorst GmbH v Finanzamt Steinfurt*, [2002] ECR I-11779.

20 ECJ, 13 March 2007, C-524/04, *Test Claimants in the Thin Cap Group Litigation v. Commissioners of Inland Revenue*, [2007] ECR I-02107.

21 See *inter alia* ECJ, 9 February 2006, C-399/03, *Kingdom of Belgium (C-182/03) and Forum 187 ASBL (C-217/03) v Commission of the European Communities ['Belgian coordination centres']*, [2006] ECR I-05479; ECJ, 2 July 1974, C-173/73, *Italian Republic v Commission of the European Communities*, [1974] ECR 00709.

22 Commission Decision 2003/757/EC of 17 February 2003 on the aid scheme implemented by Belgium for coordination centres established in Belgium, *OJ* 2003 L 282.

23 Reference can be made to the letter sent by the European Commission to the Belgian Government dated February 19, 2009, 2008/4335, C(2009) 0927.

24 Royal Decree 187 of 30 December 1982 concerning the establishment of coordination centres, *Moniteur Belge/Belgisch Staatsblad*, 13 January 1983.

administrative services) through a Belgian coordination centre at a minimal tax cost.

Nevertheless, this regime has been declared incompatible with the common market on the basis of the article 87(1) EC Treaty[25] by an EU Commission decision dated 17 February 2003[26]. Following this decision, the NID regime has been introduced in the Belgian tax system by the Belgian government, as an alternative to the coordination centre regime which will finally cease to exist on 31 December 2010.

2.1.2. Conditions to benefit from the Belgian coordination centre regime

To benefit from the Belgian coordination centre regime, an entity had to be individually approved by a special royal decree. This approval was granted for an initial period of 10 years renewable thereafter, if following conditions were met:

- Firstly, the entity had to form part of a multinational group with subsidiaries in at least 4 different countries for a period of at least 2 years before the request for coordination centre approval is submitted;

- Secondly, the multinational group had to meet some minimum consolidated turnover and equity requirements, *i.e.* respectively EUR 240 million and EUR 24 million[27];

- Thirdly, the multinational group had to employ in Belgium at least the equivalent of 10 full-time employees at the end of the first two years of the activity of the coordination centre;

- Lastly, the so-qualifying coordination centre had to perform only limited auxiliary or preparatory activities for the benefit of the multinational group members (financial transactions, insurance, accounting ...).

2.1.3. The Belgian coordination centre regime

According to its very attractive corporate tax regime, the taxable income of a coordination centre was computed on a cost plus basis, equal to the total

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25 Now TFEU, art. 107 (1).

26 Commission Decision 2003/757/EC of 17 February 2003 on the aid scheme implemented by Belgium for coordination centres established in Belgium, *OJ* 2003 L 282, p. 25.

27 Previously, BEF 10 billion and BEF 1 billion.

operating expenses and costs, excluding personal and financial costs. In addition, the resulting taxable income had to be, at least, equal to the sum of the disallowed expenses and the 'abnormal or gratuitous advantages'[28] granted to the coordination centre.

The taxable income was then subject to the Belgian corporate income tax rate at 33,99%[29], giving a very low effective rate which has been estimated approximately at 1,7%[30].

Moreover, the qualifying coordination centres benefited from following tax advantages:

- Exemption from property tax on buildings used to carry on professional activities;
- Exemption from registration duties fee on contributions made to a centre or on increases in its registered capital;
- Exemption from withholding tax on dividends, interest and royalties distributions to other group companies;
- Attractive tax status for expatriates assigned in Belgium.

2.1.4. Incompatibility of the Belgian coordination centre tax regime with EU state aid provisions

In response of the EU Code of Conduct adopted by the European Council on 1 December 1997[31] and the report of the Primarolo Group[32], the Belgian authorities were required to amend the coordination centre tax regime in

28 Basically, the expression 'abnormal or gratuitous advantages' means the advantages (any kind of enrichment) transferred to the coordination centre pursuant to non-arm's length dealings with related parties.

29 Please note that the Belgian corporate income tax rate decreased from 40,17% to 33,99% on 1 January 2003.

30 A. Haelterman and H. Verstraete, "The Notional Interest Deduction in Belgium", *Bull. IBFD*, 2008, n°8-9, p. 363.

31 Council Conclusions of the ECOFIN Council Meeting on 1 December 1997 concerning taxation policy, *OJ* 1998 C2/1.

32 Report by the Code of Conduct Group (Business Taxation), SN 4901/99, Brussels (23 November 1999), available at: *http://ec.europa.eu/taxation_customs/resources/documents/primarolo_en.pdf.*

2002[33], especially by including the personal and financial costs in the cost plus taxable basis and by abolishing the exemption from the property tax on buildings used to carry on professional activities.

Despite the amendments introduced to the Belgian coordination centre regime, the EU Commission declared it incompatible with the common market on the basis of the article 87 (1) EC Treaty[34] in a decision dated on 17 February 2003[35]. Accordingly, the EU Commission allowed the coordination centres approved by the Belgian government prior to 17 February 2003 to keep running until the end of their approval period, but no later than 31 December 2010. Nevertheless, the EU Commission disallowed the Belgian authorities to renew approvals for coordination centres when they expired after the notification of its decision, *i.e.* after 17 February 2003.

The EU Commission decision was contested, before the ECJ, by the Belgian authorities and by Forum 187 ASBL, an organisation representing about 90% of the Belgian coordination centres. They argued in particular that the coordination centres, whose status expired in 2003 or, shortly thereafter, had not been given any time to make alternative arrangements in order to avoid suffering the full consequences of the normal Belgian tax regime.

In its *Belgian coordination centre* decision[36], the ECJ confirmed that the Belgian coordination centre regime met the following criteria and could thus be termed illegitimate state aid within the meaning of the article 87(1) EC Treaty[37]:

- Firstly, the coordination centres were favoured because they benefited from a special tax regime conferring them an advantage by comparing the ordinary tax system[38];

33 Belgian law of 24 December 2002 modifying the Belgian corporate income tax regime, *Moniteur Belge/Belgisch Staatsblad*, 31 December 2002.

34 Now TFEU, art. 107 (1).

35 Commission Decision 2003/757/EC of 17 February 2003 on the aid scheme implemented by Belgium for coordination Centres established in Belgium, *OJ* 2003 L 282.

36 *Belgian coordination centres, supra,* fn n°20.

37 Now TFEU, art. 107 (1).

38 *Belgian coordination centres , supra,* fn n°20, par. 95.

- Secondly, the advantages conferred by the coordination centre status were granted directly or indirectly through State resources and imputable to the State[39];

- Thirdly, the ECJ noted that this specific tax regime was only granted to qualifying entities meeting certain conditions[40];

- Lastly, the ECJ found that the advantages conferred by the coordination centre status affected trade and distorted competition between Member States[41], highlighting its settled case-law according which competition is distorted where a measure mitigates the burden imposed on a beneficiary undertaking and thereby strengthens its position as regards competing undertakings[42].

However, the ECJ agreed with the Belgian authorities and Forum 187 ASBL on their transitional argument, stating that the EU Commission decision "*must be annulled in so far as it does not lay down transitional measures for those coordination centres with an application for renewal of their authorisation pending on the date on which the contested decision was notified or with an authorisation which expired at the same time as or shortly after the notification of the decision"*[43].

Following the ECJ decision, the EU Commission issued thus a new decision related to the Belgian coordination centre[44] according to which a transitional period had to be allowed to the coordination centres to make alternative arrangements until 31 December 2005. In other words, the Belgian authorities were allowed to renew coordination centre approvals that expired no later than 31 December 2005 and, consequently, the coordination centres were/are able to continue to benefit from their special tax regime until the end of their approval period, but no later than 31 December 2010.

39 *Ibid.*, par. 127, 128 and 129.

40 *Ibid.,* par. 122-123.

41 *Ibid.,* par. 132.

42 ECJ, 17 September 1980, C-730/79, *Philip Morris v Commission*, [1980] ECR 2671, par. 11; ECJ, 11 November 1987, C-259/85, *France v Commission*, [1987] ECR 4393, par. 24.

43 *Belgian coordination centres*, *supra,* fn n°20, par. 174.

44 Commission Decision 2008/283/EC of 13 November 2007 amending Decision 2003/757/EC on the aid scheme implemented by Belgium for coordination centres established in Belgium *OJ* 2008 L 90, p. 7.

2.2. Description of the Belgian NID regime[45]

2.2.1. Generalities

In looking for a replacement for the attractive coordination centre regime, the Belgian authorities came up with the NID regime. Introduced in the articles 205bis to 205novis of the Belgian Income Tax Code ("BITC") on 1 January 2006[46], the NID regime is available to all Belgian tax-resident companies, but also to non-resident companies taxable in Belgium in order to avoid any issues in terms of compatibility with EU law.

The main purpose of the NID regime is to mitigate the unjustified discrimination between debt financing and equity financing[47]. As a general principle of international taxation, debt financing is more favourable than equity financing in a tax perspective. Indeed, interests are generally deductible from the taxable base of the borrowing company, whereas dividends are in principle not deductible at the level of the subsidiary company[48]. By introducing the NID regime, the Belgian authorities have aimed to limit the effects of this disparity, which is unanimously considered to be a major obstacle to corporate development[49]. In this respect, it should be pointed out that the 0.5% registration duty on capital contributions in the capital of a Belgian company (incorporation or subsequent capital increases) was also abolished as of 1 January 2006.

Consequently, this innovative and powerful measure in international tax law enables qualifying companies to deduct from their taxable income a fictitious interest[50] calculated on the basis of their shareholder's equity (net assets). In this respect, the Belgian NID regime is intended to benefit to all companies, from small-sized national enterprises to big multinationals, by

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45 For a detailed analysis of the NID regime, please see A. Haelterman and H. Verstraete, *op. cit.*

46 Law of 22 June 2005 implementing the tax deduction for risk capital, *Moniteur Belge/Belgisch Staatsblad,* 22 June 2005.

47 Explanatory Memorandum, *Parl. Doc., Kamer 2004-2005,* No. 51-1778/001, 4-6.

48 A. Miller and L. Oats, *Principles of International Taxation,* Tottel Publishing Ltd, West Sussex, 2009, p. 230.

49 See *e.g.* the Report from the EU High Level Group chaired by Wim Kok, "Facing the challenge: the Lisbon Strategy for growth and employment", November 2004, available at Luxembourg: Office for Official Publications of the European Communities; see also A. Haelterman and H. Verstraete, *op. cit.*, p. 363.

50 There is thus no withholding tax on the notional interest deduction.

favouring the strengthening of their equity and by offering interesting tax-planning opportunities for both Belgian and foreign entities.

In addition, by reducing the effective corporate tax rate of qualifying companies to a very low effective rate, which has been estimated approximately at 26-27%, and at a significant lower rate for capital-intensive activities such as financing (could be as low as 0%)[51], the NID regime enables Belgium to remain fiscally attractive in comparison with its main competing countries. The current Belgian nominal corporate tax rate (33,99%) is indeed one of the highest in the EU, only below France (34,4%) and Malta (35%), but far above other countries such as the Netherlands (25%) or the other EU countries whose average nominal corporate tax rate is 23,5%[52].

2.2.2. Scope of application

The scope of application of the NID regime covers both Belgian entities, subject to Belgian corporate income tax, and Belgian establishment of foreign enterprises that are subject to the Belgian non-resident corporate income tax[53], which means that the NID regime is automatically applicable to following entities:

- Belgian companies;
- Belgian branches of foreign companies;
- Non-profit organisations (international or national) and foundations subject to Belgian corporate income tax;
- Foreign companies that own real estate located in Belgium or hold property rights in such real estate.

It should be pointed out that the NID regime does not apply to some entities subject to the Belgian corporate income tax because they already benefit from the following specific and more preferential taxation regimes[54]:

51 D. Garabedian and J.-M. Degee, "Notional Interest Deduction Rebalances Equity and Borrowings", *www.internationallawoffice.com*, 21 October 2005.

52 F. Vanistendael, "Een aanvulling op de notionele interestaftrek", *A.F.T.*, 2010, n°2, p. 2.

53 BITC, art. 205*bis* and 235, 2°.

54 BITC, art. 205*octies*.

- Collective investment companies as referred to in articles 14, 19 and 24 of the Belgian law of 20 July 2004 (*e.g.* SICAV/BEVEK, SICAF/BEVAK and SIC/VBS);
- Recognised Belgian coordination centres still benefiting from the tax regime provided by the Royal Decree 187 of 30 December 1982;
- Reconversion companies still benefiting from the tax regime provided by the Belgian law of 31 July 1984;
- Cooperative participation companies as referred to in the Belgian law of 22 May 2001;
- Shipping companies benefiting of the "tonnage" tax regime provided by the Belgian law of 2 August 2002.

In addition, Small and Medium-sized Enterprises ("SMEs")[55], having opted to set up an investment reserve, are not allowed to apply the Belgian NID regime for the taxable period in which the investment reserve is set up, nor for the following 2 years[56].

2.2.3. Calculation of the fiscal deduction

2.2.3.1. The risk capital

a) Determination of the accounting equity

In order to determine the amount of risk capital, the accounting equity of the company as recorded in the annual accounts, according to the Belgian GAAP at the end of the preceding taxable period is taken as a starting point[57].

According to Belgian accounting rules[58], the accounting equity of a company includes the company's capital, share premiums, revaluation capital gains, reserves, carry-forward of profits or losses, and capital investment subsidies.

55 The notion "SME-company" is to be interpreted as stipulated in article 15, §1 of the Belgian Code of Companies.

56 BITC, art. 205*novies*.

57 BITC, art. 205*ter*, par.1, 1st indent.

58 Royal Decree implementing the Belgian Code of Companies, art. 88.

Moreover, the application of full Belgian GAAP is considered as a prerequisite for a company to qualify for the Belgian NID regime[59]. However, according to Belgian company law, not all Belgian and foreign entities present in Belgium are required to apply full Belgian GAAP. Indeed, following entities are exempted from this accounting obligation:

- Foreign companies with a permanent establishment or real estate in Belgium without there being a branch for company law purposes[60];

- Foreign companies with a permanent establishment without its own proceeds from the sale of goods or provision of services to third parties or to the company to which it belongs and of which the operating costs are borne by this company[61].

Therefore, those entities are, in principle, not allowed to apply the NID regime, except if they voluntary apply Belgian GAAP according to Belgian company law. In an EU context, the question arises whether or not this additional requirement is compatible with EU law? This question will be analyzed in details at the point 3.3.2 of this paper.

b) Adjustment to the accounting equity

In order to obtain the qualifying equity which forms the basis for the calculation of the deduction, the accounting equity as determined above must then be adjusted by eliminating following elements:

- Financial fixed assets consisting of participations and other shares[62].

Firstly, in order to avoid a 'cascade effect', the fiscal net value of financial fixed assets, consisting of participations and other shares, must be deducted from the NID calculation base. Theoretically, a share in the hands of one company represents indeed part of the

59 Royal Decree implementing the BITC (“RD/BITC”), Art. 73/4*septies*, par. 1.

60 Belgian Code of Companies, art. 58.

61 Belgian Code of Companies, art. 92, § 2.

62 BITC, art. 205*ter*, par. 1, 2nd indent(a) and Explanatory Memorandum, *Parl. Doc. Kamer 2004-2005,* No. 51-1778/001, note 21, at 12.

capital of another company, which itself qualifies in principle for the deduction for risk capital.

Nevertheless, it should be pointed out that there are situations where the fiscal net value of financial fixed assets, consisting of participations and other shares, corresponds to part of the capital of another company, which does not qualify for DRC regime. Indeed, as mentioned above, Belgian companies benefiting from specific and more preferential taxation regimes or foreign companies with no presence in Belgium do not qualify for the Belgian DRC regime[63].

- Own shares in portfolio[64].

Furthermore, the deduction of fiscal net value of own shares has also be justified by the Belgian authorities in order to avoid the same 'cascade effect'. Nevertheless, as correctly stated by Professor Henk Verstraete and Professor Axel Haelterman, this concern is not present in the case of holding own shares and the real reason is most likely that own shares do not economically represent funds made available to the company[65].

- Shares in investment companies[66].

Moreover, the fiscal net value of shares in investment companies, the dividends of which qualify for dividend received deduction must be deducted from the NID calculation base. The reason of this exclusion is to prevent companies to benefit from both the NID regime and the dividend received deduction regime[67].

63 A. Haelterman and H. Verstraete, *op. cit.*, p. 365.

64 BITC, art. 205*ter*, par. 1, 2nd indent(a) and Explanatory Memorandum, *Parl. Doc. Kamer 2004-2005,* No. 51-1778/001, note 21, at 12.

65 A. Haelterman and H. Verstraete, *op. cit.*, p. 365.

66 BITC, art. 205*ter*, par. 1, 2nd indent (b).

67 For a detailed analysis of the Belgian dividend received deduction regime, please see F. Dierckx, “Belgium Holding Company Regime – Past, Present and Future”, *Bulletin for International Taxation 8/9,* 2008, 404-414; G. Cruysmans, “The Belgian Participation Exemption Regime and the ECJ’s Decisions in *Cobelfret* and *KBC/BRB*”, *International Tax Report*, April 2010, pp. 1-10.

- Assets whose income is not taxable in Belgium[68].

In addition, where a foreign company has branches or owns real estate in a country with which Belgium has concluded a double taxation treaty, the net value of the assets connected with the branches or with the real estate is excluded from the basis on which the notional interest deduction is computed. The reason of this exclusion is that the income of the branches or from the real estate is exempted from tax in Belgium, under the relevant double taxation treaty. In this respect, the Belgian authorities aimed to limit the benefits of the NID regime to equity-generating taxable income in Belgium.

Because the latter exclusion does not apply to similar investments made in Belgium, the question arises whether or not this exclusion is compatible with EU law[69]? This question will be analyzed in details at the point 3.3.1 of this paper.

- Anti-abuse provisions[70].

In order to prevent companies from artificially increasing the computation base for the risk capital, the following elements must also be deducted:

- The net book value of material fixed assets or parts of it, as far as the relating costs unreasonably exceed professional needs;
- The book value of the components used as an investment and which are by nature not expected to produce recurring income (for instance private assets such as art work, jewelleries, gold, etc.);
- The book value of real estate or real rights for which the use is granted directors, managers, liquidators or persons with similar functions, their spouses or children (in case these persons or their spouses have the legal usufruct of their children's' revenues).

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68 BITC, art. 205*ter*, par. 2 and 3.

69 M. Dassesse, "Does the Belgian DCR regime infringe European law?" *Tax planning international review*, 2009, n°1.

70 BITC, art. 205*ter*, §4 and Explanatory Memorandum, *Parl. Doc. Kamer 2004-2005,* No. 51-1778/001, note 21, at 13.

- Tax-exempt elements[71].

Finally, the reserves resulting from the mere evaluation of assets and the subsidies that are part of a company's own funds must also be excluded from the NID computation base.

c) Change in the accounting equity[72]

In case the qualifying accounting equity or any excluded elements would change during the taxable period, the risk capital needs to be increased or decreased on a weighted average basis with the amount of the changes.

The reason of this rule is to avoid any year-end manipulations with a view to increase the NID amount[73].

2.2.3.2. Interest rates[74]

The applicable interest rate has been fixed at 3,8% for tax years 2011 and 2012 (4,3% for SMEs)[75].

Previously, the applicable interest rate was equal to the annual average of the monthly published interest rates for 10-year linear Belgian government bonds over the year taken two years before the tax year concerned (*e.g.* the average of the interest rates of 2007 for tax year 2009).

2.2.4. Formalities

In order to claim the NID, a special form must be added to the corporate income tax return (Form 275C)[76].

In case of insufficient taxable profits to fully deduct the NID, the excess deduction can be carried forward to 7 subsequent taxable periods[77].

71 BITC, art. 205*ter*, par. 5.

72 BITC, art. 205*ter*, par. 6 .

73 Explanatory Memorandum, *Parl. Doc. Kamer 2004-2005,* No. 51-1778/001, note 21, at 15.

74 BITC, art. 205*quater*.

75 See *supra,* fn n°54.

76 BITC, art. 205*septies*.

77 BITC, art. 205*quinquies*.

However, this carry-forward privilege is lost in the case of a change of control over the company, when such a change cannot be justified for financial or economic reasons[78].

In addition, the (carried-forward) notional interest deduction cannot be off-set against abnormal or benevolent advantages received[79] because these advantages are effectively taxed in the year in which they are received[80].

3. Compatibility of the NID regime with EU law

3.1. Issues to be examined

As already mentioned[81], the scope of application of the NID regime covers both Belgian companies subject to Belgian corporate income tax and Belgian establishment of foreign companies subject to the Belgian non-resident corporate income tax. Therefore, the entire Belgian NID regime can be, theoretically, viewed as compatible with EU law, but it should be noted that two aspects of this regime may be questioned in terms of compatibility with EU law:

1) The legal exclusion from the NID computation of the net equity corresponding to the net value of branches or real estate located in treaty countries[82].

As already mentioned[83], the net equity of a Belgian company corresponding to the net value of branches or real estate located in treaty countries is excluded from the basis on which the notional interest deduction is computed.

Because this exclusion does not apply to similar investments made in Belgium, the EU Commission has opened infringement procedures on 19 February 2009 against Belgium, arguing that the NID regime violates the free movement of capital and the freedom of establishment[84]. In response, the Belgian authorities have informed the EU Commission of their disagreement with its position and of their intention to

78 BITC, art. 207, 3rd indent.

79 See *supra,* fn n°27.

80 BITC, art. 207, 2nd indent and art. 79.

81 See point 2.2.1 of this paper.

82 BITC, art. 205ter, §2 and §3.

83 See point 2.2.3.1.b) of this paper.

84 See the letter sent by the European Commission to the Belgian Government dated February 19, 2009, 2008/4335, C(2009) 0927.

continue the current NID regime without any amendment. We are still waiting to the reaction of the EU Commission, if the EU Commission decides to react…

Therefore, the question to analyze in this situation is whether or not the legal exclusion, from the basis for calculation of the NID computation, of the net equity corresponding to the net value of branches or real estate located in treaty countries is compatible with EU law.

2) The legal requirement for Belgian permanent establishments of foreign companies to apply full Belgian GAAP in order to benefit from the NID regime[85].

As already mentioned[86], although not all Belgian and foreign companies present in Belgium are required to apply full Belgian GAAP according to Belgian company law[87], the latter requirement is a prerequisite for Belgian permanent establishments of foreign entities to benefit from the NID regime[88]. Therefore, such entities are only allowed to benefit from the NID regime if they voluntary decide to apply full Belgian GAAP.

The reason of this legal requirement is to ensure that foreign companies provide with the correct figures in order to determine the amount of NID which can be applied at the level of their Belgian permanent establishments.

Therefore, the question to analyze in this situation is whether or not the denial of the benefit of the NID regime to Belgian permanent establishments of foreign companies that do not apply full Belgian GAAP is compatible with EU law.

3.2. Fundamental EU principles relevant to the issues

3.2.1. The non-discrimination principle and the fundamental freedoms

The Member States have agreed to abolish any legislative, administrative or procedural obstacles to the exercise of the four fundamental freedoms: free movement of goods[89], free movement rights of persons (free movement of workers[90] and freedom of establishment[91]), free movement of services[92] and

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85 RD/BITC, art. 73/4*septies*, par. 1.

86 See point 2.2.3.1.a) of this paper.

87 For Belgian entities: Belgian Code of Companies, art. 58 and for foreign entities: Belgian Code of Companies, art. 92, § 2.

88 RD/BITC, art. 73/4*septies*, par. 1.

89 EC Treaty, art. 23 (Now TFEU, art. 28).

90 EC Treaty, art. 39 (Now TFEU, art. 45).

free movement of capital[93]. The freedoms are actually a more specific expression of the general principle of "non-discrimination on ground of nationality"[94], covering all aspects of the economy, including direct taxation matters[95].

According to the ECJ, "*discrimination can arise only through the application of different rules to comparable situations or the application of the same rule to different situations"*[96]. In addition, the ECJ has generally made a distinction between overt discrimination, based on nationality, and covert discrimination, based on other criteria such as tax residence. In this respect, while it has been confirmed that theoretically, "*the situations of residents and non-residents are not, as a rule, comparable*"[97], the ECJ has added that the non-discrimination principle within the meaning of the article 12 EC Treaty[98], "*forbid*(s) *not only overt discrimination by reason of nationality but also all covert forms of discrimination which, by the application of other criteria of differentiation, lead in fact to the same result. (...) It may therefore be that criteria such as place of origin of residence (...) may, according to circumstances, be tantamount, as regards their practical effect, to discrimination on the grounds of nationality, such as is prohibited by the Treaty (...)"*[99]. In other words, discrimination on the grounds of other criteria, such as tax residence, may also be prohibited under EU law in certain circumstances while, for example, there is no objective difference between the situation of residents and non-residents. In such case, non-residents may not be treated less favourably than residents[100].

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91 EC Treaty, art. 43 (Now TFEU, art. 49).

92 EC Treaty, art. 49 (Now TFEU, art. 56).

93 EC Treaty, art. 56 (Now TFEU, art. 63).

94 EC Treaty, art. 12 (Now TFEU, art. 18).

95 ECJ, 8 May 1990, C-175/88, *Klaus Biehl v Administration des contributions du grand-duché de Luxembourg,* [1990] ECR I-01779 ; ECJ, 5 July 2005, C-376/03, *D. v Inspecteur van de Belastingdienst/ Particulieren/ Ondernemingen buitenland te Heerlen*, [2005] ECR I-05821.

96 *Schumacker, supra,* fn n°10, par. 30.

97 *Ibid.,* par. 31; *Wielockx, supra,* fn n°10, par. 18.

98 Now TFEU, art. 18.

99 ECJ, 12 February 1974, C-153/73, *Giovanni Maria Sotgiu v. Deutsche Bundespost,* [1974] ECR 153, par. 11.

100 See also *Schumacker, supra,* fn n°10, par. 36-37; *Wielockx, supra,* fn n°10, par. 20-22; *Test Claimants in Class IV of the ACT Group Litigation, supra,* fn n°12, par. 68; *Denkavit Internationaal, supra,* fn n°12, par. 35-36.

Reference can, for example, be made to the *Commerzbank* case in which the ECJ highlighted that: "(a)*lthough it applies independently of a company's seat, the use of the criterion of fiscal residence within national territory for the purpose of granting repayment supplement on overpaid tax is liable to work more particularly to the disadvantage of companies having their seat in other Member States. Indeed, it is most often those companies which are resident for tax purposes outside the territory of the Member State in question"*[101].

In the last few years, it should be pointed out that the ECJ approach to protect the fundamental freedoms has evolved from a prohibition of any "discrimination" in an EU context to a prohibition of any "restriction" in an EU context, without abandoning the former. In the *Dassonville* case[102], the ECJ highlighted, for the first time, that *"all trading rules enacted by Member States which are capable of hindering, directly or indirectly, actually or potentially, intra Community trade are to be considered as measures having an effect equivalent to quantitative restrictions*". In other words, under the restriction approach, the national rules which hinder the exercise of the fundamental freedoms and which, consequently, affect intra-EU trade should be eliminated, even if their scope *ratione personae* apply without any discrimination[103].

Finally, it should be noted that, in the ECJ reasoning, a national measure constituting a restriction of the fundamental freedoms may, nevertheless, be permissible, *"only if it pursues a legitimate objective compatible with the Treaty and is justified by imperative reasons in the public interests. It is further necessary* (...) *that its application be appropriate to ensuring the attainment of the objective thus pursued and not go beyond what is necessary to attain it"*[104].

3.2.2. The freedom of establishment

Insofar as companies are concerned, the freedom of establishment within the meaning of article 48 EC Treaty[105] mainly aims at prohibiting all

101 ECJ, 13 July 1993, C-330/91, *The Queen v Inland Revenue Commissioners, ex parte Commerzbank AG,* [1993] ECR I-04017, par. 15.

102 ECJ, 11 July 1974, Case 8-74, *Procureur du Roi v Benoît and Gustave Dassonville,* [1974] ECR 00837, par. 5.

103 See *inter alia* ECJ, 15 May 1997, Case C-250/95, *Futura Participations SA and Singer v Administration des contributions*, [1997] ECR I-02471; see also *Eurowings;* ECJ, 19 January 2006, C-265/04, *Margaretha Bouanich v Skatteverket*, [2006] ECR I-00923.

104 See *inter alia Marks & Spencer, supra*, fn n°15, par. 35; *Futura, supra,* fn n°102, par. 26.

105 Now TFEU, art. 56.

discrimination based on the place where the registered office, central administration or principal place of business of a company is situated[106]. Broadly interpreted by the ECJ[107], the freedom of establishment generally guarantees the right to set up a primary establishment (new company) or a secondary one (agency, branch or subsidiary).

The ECJ has clarified the notion of 'establishment' by stating that "*even though, according to their wording, the provisions of the Treaty concerning freedom of establishment are directed to ensuring that foreign nationals and companies are treated in the host Member State in the same way as nationals of that State, they also prohibit the Member State of origin from hindering the establishment in another Member State of one of its nationals or of a company incorporated under its legislation*"[108].

It should be pointed out that EEA third countries ("European Economic Area"), *i.e.* Iceland, Liechtenstein and Norway, can rely on the EU freedom of establishment principles, according to the article 31 of the EEA Treaty.

3.2.3. The free movement of capital

The free movement of capital within the meaning of articles 56 EC Treaty *et seq.*[109] mainly aims at prohibiting all restrictions on the movement of capital and on payment between Member States, and between Member States and third countries. The notion of 'movement of capital and on payment' is not defined in the EC Treaty[110], but, according to the ECJ settled case-law[111], inasmuch as articles 56 EC Treaty *et seq.*[112] essentially reproduce the contents of article 1 of Directive 88/361, the nomenclature in respect of

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106 ECJ, 18 July 2007, C-231/05, *OY AA*, [2007] ECR I-06373, par. 30.

107 See *e.g.* ECJ, 13 December 2005, C-411/03, *Sevic Systems AG*, [2005] ECR I-10805; ECJ, 16 December 2008, C-210/06, *Cartesio Oktató és Szolgáltató bt*, [2008] ECR I-09641.

108 ECJ, 16 July 1998, C-264/96, *Imperial Chemical Industries plc (ICI) v Kenneth Hall Colmer (Her Majesty's Inspector of Taxes)*, [1998] ECR I-4695, par. 21; ECJ, 6 December 2007, C-298/05, *Columbus Container Services BVBA & Co. v Finanzamt Bielefeld-Innenstadt*, [2007] ECR I-10451, par. 33; *Cadbury Schweppes, supra,* fn n°16, par. 42.

109 Now TFEU, art. 63.

110 Now TFEU.

111 ECJ, 16 March 1999, C-222/97, *Manfred Trummer and Peter Mayer*, [1999] ECR I-01661, par 21; ECJ, 5 March 2002, C-515/99, C-519/99 to C-524/99 and C-526/99 to C-540/99, *Hans Reisch and Others*, [2002] ECR I-02157, par 30; ECJ, 23 February 2006, C-513/03, *Heirs of M. E. A. van Hilten-van der Heijden v Inspecteur van de Belastingdienst Particulieren/ Ondernemingen buitenland te Heerlen*, [2006] ECR I-01957, par 3.

112 Now TFEU, art. 63.

'movements of capital' annexed to that directive still has the same indicative value, for the purpose of defining the notion of capital movements.

It should be pointed out that the free movement of capital is the only freedom available to third country nationals since the Treaty of Maastricht transposed the key provisions of the Directive 88/361/EEC directly into the EC Treaty, liberalizing capital movements within EU, but also in relation to third countries, with direct effect from 1 January 1994[113].

3.2.4. Freedom of establishment *vs* free movement of capital: application of the 'prevailing freedom'[114]

The wide definition and interpretation of the concepts of 'establishment' and 'movement of capital' can lead to situations where a national rule may impact both the freedom of establishment and the free movement of capital[115]. The possibility of freedoms overlap is indeed expressly acknowledged in the wording of some of the fundamental freedoms[116].

In order to prevent the examination of any possible restriction of the free movement two (or more) times, the ECJ has thus developed the 'prevailing freedom' principle[117]. Accordingly, where a national rule relates to more than one freedom at the same time, the ECJ will, in principle, examine the rule in dispute in relation to only one of those freedoms if it appears, in the

113 ECJ, 23 February 1995, C-358/93 and C-416/93, *Criminal proceedings against Aldo Bordessa, Vicente Marí Mellado and Concepción Barbero Maestre,* [1995] ECR I-00361*;* ECJ, 14 December 1995, C-163/94, C-165/94 and C-250/94, *Criminal proceedings against Lucas Emilio Sanz de Lera, Raimundo Diaz Jimenez and Figen Kapanoglu,* [1995] ECR I-04821.

114 In this chapter, I made use of my earlier publication: G. CRUYSMANS, "The Third Country Rights and the ECJ Prevailing Freedom Principle - Implications in Direct Tax Matters", *The EC Tax Journal,* 2010, Volume 10, Issue 3, pp. 47-69.

115 K. Stahl, "Free movement of capital between Member States and third countries", *EC Tax* 2004, n°2, p. 48; D. SMIT, "The relationship between the free movement of capital and the other EC Treaty freedoms in third country relationships in the field of direct taxation: a question of exclusivity, parallelism or causality?", *EC Tax* 2007, n°6, pp. 256-267.

116 See *e.g.* EC Treaty, art. 43(2) EC and 58 (2) (Now respectively TFEU, art. 49 (2) and 65 (2))

117 ECJ, 24 March 1994, C-275/92, *Her Majesty's Customs and Excise v Gerhart Schindler and Jörg Schindler,* [1994] ECR I-01039, par. 22; ECJ, 22 January 2002, C-390/99, *Canal Satélite Digital SL v Adminstración General del Estado, and Distribuidora de Televisión Digital SA (DTS),* [2002] ECR I-00607, par. 31; ECJ, 25 March 2004, C-71/02, *Herbert Karner Industrie-Auktionen GmbH v Troostwijk GmbH,* [2004] ECR I-03025, par 46; ECJ, 14 October 2004, C-36/02, *Omega Spielhallen- und Automatenaufstellungs-GmbH v Oberbürgermeisterin der Bundesstadt Bonn,* [2004] ECR I-09609, par. 26; ECJ, 26 May 2005, C-20/03, *Criminal proceedings against Marcel Burmanjer, René Alexander Van Der Linden and Anthony De Jong,* [2005] ECR I-4133, par. 35.

circumstances of the case, that one or more of them are entirely secondary in relation to one other and may be considered together with it. In this respect, it is necessary to examine to what extent the exercise of the fundamental freedoms is affected and whether, in the circumstances of the main proceedings, one of those prevails over the other(s)[118]. If it appears that a freedom prevails over the other(s), the ECJ will in principle state that the restrictive effects of the national rule on the indirectly affected freedom(s) are merely an inevitable consequence of the restriction imposed on the directly affected freedom and that it is no need or no justification to consider whether the rules are compatible with indirectly affected freedom(s)[119].

In an intra-EU context, the practical outcome for the parties in ECJ cases has not been usually a function of which freedom was relied on. The ECJ has, consequently, never selected only one of two (or more) affected freedoms against which to judge the compatibility of a national measure in circumstances where it could change the practical result of the case[120].

However, in a third country context, the application of the 'prevailing freedom' principle may have an important impact[121]. Indeed, in a case with a third country dimension concerning, for example, both the free movement of capital and the freedom of establishment, the ECJ may decide that the freedom of establishment prevails and, therefore, exclude consideration of the free movement of capital, which was, actually, the only freedom available to third country nationals.

3.3. Analysis

3.3.1. Exclusion from the NID basis of the net equity corresponding to foreign branches and foreign real estate

3.3.1.1. Step 1: Restriction on the freedom of establishment and/or the free movement of capital

a) Branches located in treaty countries

- Restriction on the freedom of establishment

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118 *Karner, supra,* fn n°16, par. 47; *Omega, supra,* fn n°16, par. 27.

119 *Omega, supra,* fn n°16, par. 27; *Cadbury Schweppes, supra,* fn n°16, par. 33; ECJ, 28 January 1992, C-204/90, *Bachmann v Belgian State*, [1992] ECR I-00249, par. 34.

120 M. O'BRIEN, "Taxation and the third country dimension of free movement of capital in EU law: The ECJ's rulings and unresolved issues", *BTR,* 2008, n°6, p. 652.

121 ECJ, 3 October 2006, C-452/04, *Fidium Finanz AG v. Bundesanstalt fur Finanzdienstleistungsaufsicht,* [2006] ECR I-09521.

By excluding, for NID computation, the net equity of a Belgian company corresponding to the net value of its branches located in treaty countries, the Belgian NID regime has clearly the effect of discouraging such Belgian company from creating branches abroad. Indeed, because this exclusion does not apply to similar investments made in Belgium, the Belgian NID regime establishes a less favourable tax treatment for a Belgian company with branches located abroad than for a Belgian company with branches located in Belgium, the former suffering a tax disadvantage.

In this respect, reference can be made to the *Amid* decision[122] which concerned a difference of treatment between a Belgian company having a Luxemburg branch and a Belgian company having a Belgian branch. In this case, the Belgian rules refused the deductibility of a previous year loss incurred by the Belgian company, because that loss was capable of being set off against the exempted profit, made during that same previous year, by one of its permanent establishment situated in another Member State. However, had the Belgian company had a profitable permanent establishment in Belgium, the prior year loss would have been deductible in the same situation. Therefore, the ECJ decided that "*by setting off domestic losses against profits exempted by treaty, the legislation of that Member State establishes a differentiated tax treatment as between companies incorporated under national law having establishments only on national territory and those having establishments in another Member State*"[123]. In other words, a company resident in a Member State can not suffer a tax disadvantage merely, by virtue of the fact that it has set up a permanent establishment in another Member State.

This position, taken by the ECJ when analyzing a restriction on the freedom of establishment from an origin state perspective, has also been highlighted in other cases related to the discrimination between a parent company with a subsidiary located in its national territory and a parent company with a subsidiary located in another EU/EEA Member State[124]. Reference can be, for example, made to the *ICI* decision in which the ECJ argued that the freedom of establishment

122 ECJ, 14 December 2000, C-141/99, *Algemene Maatschappij voor Investering en Dienstverlening NV (AMID) v Belgische Staat*, [2000] ECR I-11619.

123 *Ibid.*, par. 23.

124 *ICI, supra*, fn n°107*;* ECJ, 18 September 2003, C-168/01, *Bosal Holding BV v Staatssecretaris van Financiën*, [2003] ECR I-09409; ECJ, 23 February 2006, C-471/04, *Finanzamt Offenbach am Main-Land v Keller Holding GmbH*, [2006] ECR I-02107; *Marks & Spencer, supra*, fn n°15.

"*precludes legislation of a Member State which, in the case of companies established in that State belonging to a consortium through which they control a holding company, by means of which they exercise their right to freedom of establishment in order to set up subsidiaries in other Member States, makes a particular form of tax relief subject to the requirement that the holding company's business consist wholly or mainly in the holding of shares in subsidiaries that are established in the Member State concerned"*[125]. In other words, when a Member State aims to make a tax incentive available to its resident subsidiary companies, the ECJ obliged it to make the same incentive available, in one form or another, to subsidiaries set up in other EU/EEA Member States and being in the same situation[126]. This rule applies exactly in the same way in the case of branches, such as in the Belgian NID regime.

Based on this, it could be argued that the exclusion for NID purposes of the net equity of a Belgian company corresponding to the net value of its branches, located in a EU/EEA Member State, may constitute a restriction on the freedom of establishment, because this exclusion does not apply to similar investments made in Belgium.

b) Real estate located in tax treaty countries

- Freedom of establishment *vs* free movement of capital

As already mentioned[127], the concepts of 'establishment' and 'movement of capital' have been defined very broadly, which can lead to situations where a national rule may impact both the freedom of establishment and the free movement of capital. In such situation, the ECJ generally aims to determine which freedom prevails on the other(s) in order to prevent the examination of any possible restriction of the free movement two times[128].

Insofar as real estate investment is concerned, the ECJ provided with some clarification in its *Centro di Musicologia Walter Stauffer* decision, by stating that "*in order for the provisions relating to freedom of establishment to apply, it is generally necessary to have*

125 *ICI, supra,* fn n°107, par. 30.

126 M. Dassesse, *op. cit.,* p. 2.

127 See points 3.2.2 and 3.2.3 of this paper.

128 See points 3.2.4 of this paper.

secured a permanent presence in the host Member State and, where immovable property is purchased and held, that property should be actively managed"[129].

Therefore, if the real estate is not actively managed in the Member State where it is situated is decisive (*e.g.* absence of premises for the purposes of pursuing the real estate activities[130]), the free movement of capital may apply. In this respect, the ECJ indeed confirmed in its *Centro di Musicologia Walter Stauffer*[131] that "(a)*mong the capital movements listed in Annex I to Directive 88/361, under heading II entitled 'Investments in real estate', are investments in real estate on national territory by non-residents"*.

In conclusion, it should be argued that, if the real estate is actively managed in the Member State where it is situated, the freedom of establishment will apply. On the contrary, if the real estate is not actively managed in the Member State where it is situated, the free movement of capital will cover both the ownership and administration of such investment.

- Restriction on the freedom of establishment

By excluding for NID computation the net equity of a Belgian company corresponding to the net value of its real estate investment located in treaty countries, the Belgian NID regime has clearly the effect of discouraging a Belgian company from investing in real estate located abroad. In this respect, the reasoning is exactly the same than for the situation of a Belgian company with branches located in EU/EEA Member States[132].

Indeed, the Belgian NID regime establishes a less favourable tax treatment for a Belgian company investing in real estate located abroad than for a Belgian company investing in Belgian real estate, the former suffering a tax disadvantage because the exclusion does not apply to the latter.

129 ECJ, 14 September 2006, C-386/04, *Centro di Musicologia Walter Stauffer v Finanzamt München für Körperschaften,* [2006] ECR I-08203, par. 19.

130 *Ibid.*

131 *Ibid* , par. 23.

132 See point 3.3.1.1.a) of this paper.

Therefore, if the real estate is actively managed in Belgium, it could be argued that the exclusion from the NID computation of a Belgian company of its investment in real estate located in another EU/EEA Member State may constitute a restriction on the freedom of establishment within the meaning of the article 48 EC Treaty[133].

- Restriction on the freedom of capital

While the real estate investment is not actively managed in Belgium, the free movement of capital may in principle be applicable and, again, the reasoning is the same as when the freedom of establishment applied.

In this situation, it could, therefore, also be argued that the exclusion from the NID computation of a Belgian company of its investment in real estate located in treaty countries may constitute a restriction of the freedom of capital within the meaning on the article 56 EC Treaty[134].

As already mentioned[135], it should be pointed out that the free movement of capital is the only freedom available to third country nationals and the free movement of capital will thus apply in the case of a Belgian company having invested in real estate situated in treaty countries, provided that the real estate investment is not actively managed in the country where it is situated.

3.3.1.2. Step 2: Justification by imperative reasons in the public interests

Based on the above analysis[136], it could reasonably be concluded that:

- The exclusion, for NID purposes, of the net equity corresponding to the net value of branches located in an EU/EEA Member State may constitute a restriction on the freedom of establishment within the meaning of article 48 EC Treaty[137];

133 Now TFEU, art. 56.

134 Now TFEU, art. 63.

135 See point 3.2.3 of this paper.

136 See point 3.3.1.1 of this paper.

137 Now TFEU, art. 56.

- The exclusion, for NID purposes, of the net equity corresponding to the net value of real estate located and actively managed in an EU/EEA Member State may constitute a restriction on the freedom of establishment within the meaning of article 48 EC Treaty[138];

- The exclusion, for NID purposes, of the net equity corresponding to the net value of real estate located in treaty countries, but not actively managed in the country where it is situated, may constitute a restriction on the freedom of capital within the meaning of article 56 EC Treaty[139].

It is then necessary to examine whether this restriction may, nevertheless, be permissible, by analyzing whether "(...) *it pursues a legitimate objective compatible with the Treaty and is justified by imperative reasons in the public interests"*[140].

In this respect, two specific justification grounds, that have already been accepted by the ECJ, may be invoked in order to justify the above restrictions:

1) The need to safeguard the balance in the allocation of taxing rights between Member States.

In its *Marks & Spencer* decision[141], the ECJ accepted, for the first time in the direct tax arena, that the need to safeguard the balance in the allocation of taxing rights between Member States should be taken into account for the purpose of determining whether or not tax legislation is compatible with the fundamental freedoms[142]. In this case, the ECJ analyzed UK loss relief rules which allowed a UK resident parent company to deduct, from its taxable base, losses incurred by its subsidiaries, only if they were also resident in the UK. Those rules were considered by the ECJ as incompatible with the freedom of establishment because they hindered UK parent companies from setting up subsidiaries in other Member States.

138 Now TFEU, art. 56.

139 Now TFEU, art. 63.

140 See *inter alia Marks & Spencer, supra,* fn n°15, par. 35.

141 *Marks & Spencer, supra,* fn n°15.

142 T. O'SHEA, *EU Tax Law and Double Tax Conventions, op. cit.,* p. 135.

The UK tax authorities argued that such rules were justified by the fact that because they did not tax non resident subsidiaries, they should, therefore, not be forced to take into account their losses because "*profits and losses are two sides of the same coin and must be treated symmetrically in the same tax system to protect a balanced allocation of the power to impose taxes between the different Member States concerned*"[143].

The ECJ agreed to a certain extent with the arguments of the UK government by stating that "*the preservation of the allocation of the power to impose taxes between Member States might make it necessary to apply to the economic activities of companies established in one of those States only the tax rules of that State in respect of both profits and losses*"[144]. However, the ECJ was also very careful to specify and delimit the conditions under which the need to safeguard the balance in the allocation of taxing rights between Member States may apply.

In particular, such a justification ground was accepted by the ECJ in its *Marks & Spencer* decision only in conjunction with two other justification grounds, *i.e.* to prevent the danger that losses would be used twice and the risk of tax avoidance[145], and provided that the rules at issue were appropriate and necessary to attain those objectives (the proportionality test)[146].

The need to safeguard the balance in the allocation of taxing rights between Member States has then been clarified by the ECJ in subsequent decisions[147]. The ECJ has especially highlighted the link exiting between such justification ground and the prevention of tax avoidance[148]. In this respect, the ECJ noted in its *SGI* decision that the need to safeguard the balance in the allocation of taxing rights between Member States may be accepted "*where the system in question is designed to prevent conduct capable of jeopardizing the*

143 *Marks & Spencer, supra,* fn n°15, par. 43.

144 *Ibid.*, par. 45.

145 *Ibid.*, par. 51.

146 *Ibid.*, par. 55.

147 See *inter alia Cadbury Schweppes, supra,* fn n°16; *OY AA, supra,* fn n°105 *;* ECJ, 21 January 2010, C-311/08, *Société de Gestion Industrielle (SGI) v Belgian State,* [2010], par. 60 ; *X Holding BV, supra,* fn n°115.

148 *OY AA, supra,* fn n°105, par. 62.

right of a Member State to exercise its tax jurisdiction in relation to activities carried out in its territory"[149]. Similarly, it stated in its *OY AA* decision that "(c)*onduct involving the creation of wholly artificial arrangements which do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out on national territory is such as to undermine the right of the Member States to exercise their tax jurisdiction in relation to those activities and jeopardize a balanced allocation between Member States of the power to impose taxes"*[150].

In *Rewe Zentralfinanz*, the ECJ also confirmed that the need to safeguard the balance in the allocation of taxing rights between Member States may not be accepted as a stand-alone justification, by arguing that "(…) *a difference in tax treatment between resident parent companies according to whether or not they have subsidiaries abroad cannot be justified merely by the fact that they have decided to carry on economic activities in another Member State, in which the State concerned cannot exercise its taxing powers. Accordingly, an argument based on the balanced allocation of the power to impose taxes between the Member States cannot in itself justify a Member State systematically refusing to grant a tax advantage to a resident parent company, on the ground that that company has developed a cross-border economic activity which does not have the immediate result of generating tax revenues for that State"*[151].

Therefore, in the present issue, it is more than likely that, according to the ECJ case-law, the need to safeguard the balance in the allocation of taxing rights between Member States may not constitute in itself a successful justification by imperative reasons in the public interests, should the exclusion of foreign branches and real estate for NID purposes have been considered as a restriction on the freedom of establishment and/or on the free movement of capital.

Indeed, as already mentioned[152], the only reason of the existence of such rule is that the income from foreign branches or from real

149 *SGI, supra,* fn n°145, par. 60.

150 *OY AA, supra,* fn n°105, par. 62.

151 ECJ, 29 March 2007, C-347/04, *Rewe Zentralfinanz eG v Finanzamt Köln-Mitte,* [2007] ECR I-02647, par. 43; see also *Marks & Spencer, supra,* fn n°15, par. 40.

152 See point 2.2.3.1.b) of this paper.

estate is exempted from tax in Belgium under the relevant double taxation treaty and that the Belgian authorities aimed to limit the benefits of the NID regime to equity-generating taxable income in Belgium. The need to safeguard the balance in the allocation of taxing rights between Member States may thus not justify in itself the Belgian authorities systematically refusing to grant the NID regime only *"on the ground that that company has developed a cross-border economic activity which does not have the immediate result of generating tax revenues for that State"*[153].

2) The need to ensure coherence of the tax system[154].

In its *Bachmann*[155] and *Commission v Belgium*[156] decisions, the ECJ accepted for the first time in the direct tax arena, that the need to ensure coherence of the tax system should be taken into account for the purpose of determining whether or not tax legislation is compatible with the fundamental freedoms. For an argument based on such a justification to succeed, the ECJ has, however, required a direct link between the granting of a tax advantage and the offsetting of that advantage by a particular tax levy[157]. In addition, *"the nature of the link must be established, in light of the objective pursued by the tax rules concerned, in relation to the relevant tax payers by a strict correlation between the deductible element and the taxable element"*[158].

153 *Rewe Zentralfinanz, supra,* fn n°150; *Marks & Spencer, supra,* fn n°15, par. 40.

154 It should be pointed out that the Belgian NID regime does not operate at the level of double tax treaties and, therefore, the role of double tax treaties in ensuring the coherence of Member States tax system is not relevant in the analysis of the present issue. For more details on the role of double tax treaties in ensuring the coherence of Member States tax system, see *Wielockx, supra,* fn n°10.

155 *Bachmann, supra,* fn n°118.

156 ECJ, 28 January 1992, C-300/90, *Commission of the European Communities v Kingdom of Belgium*, [1992] ECR I- 00305

157 ECJ, 27 November 2008, C-418/07, *Société Papillon v Ministère du Budget, des Comptes publics et de la Fonction publique*, [2008] ECR I-08947, par. 43-44; ECJ, 8 November 2007, C-293/06, *Deutsche Shell GmbH v Finanzamt für Großunternehmen in Hamburg*, [2007] ECR I-01129, par. 38.

158 *Papillon, supra,* fn n°156, par. 44; *Deutsche Shell, supra,* fn n°156, par. 39.

In its case-law[159], the ECJ has been very reluctant to accept the need to ensure coherence of the tax system as a successful justification by imperative reasons in the public interest. Reference can, for example, be made to the *ICI* decision[160] where the UK national rules allowed a UK parent company to set off losses of a subsidiary, only if it is established in the UK. In this situation, the ECJ found for example that "*there is no* (...) *direct link between the consortium relief granted for losses incurred by a resident subsidiary and the taxation of profits made by non-residents subsidiaries"*[161].

In the present issue, it is more than likely that, according to the ECJ case-law as analyzed, the need to ensure coherence of the tax system will not constitute a successful justification by imperative reasons in the public interests, should the exclusion of foreign branches and real estate for NID purposes have been considered as a restriction on the freedom of establishment and/or on the free movement of capital.

Indeed, the NID regime represents a fictitious and autonomous tax advantage calculated on the basis of the shareholder's equity of a company. Therefore, there is no direct link between granting the NID to this company and the taxation of any profit related to investment made by it through foreign branches or foreign real estate[162].

To conclude on this point, it should also be noted that, insofar as justification grounds are concerned, the third country dimension, in a case involving the free movement of capital, may be relevant in the ECJ analysis. In this respect, the ECJ has indeed considered that free movement of capital between Member States takes place in a different legal context from that in an intra-EU context[163] because of, *inter alia,* the Member States' obligation to exchange

159 See *inter alia ICI, supra,* fn n°107*;* ECJ, 13 April 2000, C-251/98, *C. Baars v Inspecteur der Belastingen Particulieren/ Ondernemingen Gorinchem,* [2000] ECR I-02787*; Deutsche Shell, supra,* fn n°156*.*

160 *ICI, supra,* fn n°107.

161 *Ibid.,* par. 29.

162 M. Dassesse, *op. cit.,* p. 4 ; see also the letter sent by the European Commission to the Belgian Government dated February 19, 2009, 2008/4335, C(2009) 0927.

163 ECJ, 18 December 2007, C-101/05, *Skatteverket contre A,* [2007] ECR I-11531, par .60; ECJ, 4 June 2009, C-439 and C-499/07*, Belgische Staat contre KBC Bank NV, et Beleggen, Risicokapitaal, Beheer NV contre Belgische Staat,* [2009], par. 72.

information under the Mutual assistance Directive[164] and the Savings Directive[165] or the enforcement of tax judgments intra-EU[166]. It has, therefore, appeared in the ECJ case-law[167] that some justifications to restriction which have been rejected in intra-EU cases have been, however, considered as valid in third country cases[168]. In other words, a restriction affecting third country nationals may be justified more easily than a restriction affecting Community nationals[169]. In the present issue, it should thus be noted that in the case of real estate which is not actively managed in Belgium, the ECJ may be more open to accept grounds for justification than in an intra-EU context, should the exclusion of real estate for NID purposes have been considered as a restriction on the free movement of capital.

3.3.2. Obligations for Belgian permanent establishments to apply Belgian GAAP accounting

3.3.2.1. Step 1: Restriction on the freedom of establishment

As already mentioned[170], the entities exempted from the obligation to apply full Belgian GAAP according to Belgian company legislation are, nevertheless, required to comply with full Belgian GAAP in order to benefit from the NID regime according to the Belgian tax legislation[171]. While this rule does not in itself

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164 Council Directive 2004/56/EC of 21 April 2004 amending Directive 77/799/EEC concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation, certain excise duties and taxation of insurance premiums, *OJ* L 127, 29.4.2004, pp. 70–72.

165 Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments, *OJ* L 157, 26.6.2003, pp. 38–48.

166 C. Panayi, “The Fundamental Freedoms and Third Countries: Recent Perspectives”, *ET*, 2008, n°11, 582.

167 See *inter alia A, supra,* fn n°160; *Test Claimants in the Thin Cap Group Litigation, supra,* fn n°19.

168 See *Test Claimants in the FII Group Litigation, supra,* fn n°19, par. 171.

169 For a more detailed analysis on this issue, see L. JANSSENS, “Pays tiers: mêmes restrictions, autres motifs de justification?”, *Fiscologue (I.)* 2008, n°289, p. 6-9; C. PANAYI, *op. cit.*, pp. 579-582; M. O’BRIEN, *op. cit.*, pp. 662-666; P. PISTONE, “The Impact of European Law on the Relations with Third Countries in the Field of Direct Taxation”, *Intertax* 2006, n°34, pp. 234-244.

170 See point 2.2.3.1.a) of this paper.

171 RD/BITC, art. 73/4*septies*, par. 1.

discriminate Belgian permanent establishments of foreign companies and Belgian companies which are, consequently, treated in the same way, it may, nevertheless, constitute an infringement of EU law under the ECJ restriction approach. As already mentioned[172], under the latter approach, the national rules which hinder the exercise of the fundamental freedoms and which, consequently, affect intra-EU trade should be eliminated, even if their scope *ratione personae* applies without any discrimination[173].

In the present issue, reference can be made to the ECJ *Futura* decision[174]. This decision concerned a French company with a branch in Luxemburg. According to Luxemburg non-residents taxation rules, non-residents are only taxable on their 'locally received' income and are not obliged to keep separate accounts relating to their Luxembourg activities. If they do so, they are allowed to determine the amount of their taxable income in Luxembourg on the basis of an apportionment of their total income, whereby a proportion of that income is treated as arising from the taxpayer's Luxembourg activities.

However, non-resident taxpayers are only allowed to deduct, from the total of their net income, previous losses carried forward from previous years, provided that two following conditions are met:

- The losses must be economically related to income received locally; and
- The non-residents taxpayers must have Luxembourg accounts.

In this respect, the ECJ was asked whether or not the two above conditions impede the freedom of establishment[175]?

While the ECJ stated that the first condition, which is in conformity with the fiscal principle of territoriality, complied with EU law[176], the ECJ applied then a restriction approach with respect to the

172 See point 3.2.1 of this paper.

173 See *inter alia Futura, supra,* fn n°102 *; Bouanich, supra,* fn n°102.

174 *Futura, supra,* fn n°102*.*

175 *Ibid.*, par. 16-17.

176 *Ibid.*, par. 22.

second condition[177]. Accordingly, the ECJ noted that "*if such a company or firm wishes to carry forward any losses incurred by its branch, it must keep, in addition to its own accounts which must comply with the tax accounting rules applicable in the Member State in which it has its seat, separate accounts for its branch's activities complying with the tax accounting rules applicable in the State in which its branch is established. Furthermore, those separate accounts must be held, not at the company's seat, but at the place of establishment of its branch*"[178]. Consequently, the ECJ concluded that the requirement of keeping a second set of accounts in order to obtain loss relief, which specifically affects companies having their seat in another Member State, constituted a restriction on the freedom of establishment[179].

Based on the above ECJ *Futura* decision[180], it could be argued, in the present issue, that the denial of the NID regime to Belgian permanent establishments of foreign companies which do not apply full Belgian GAAP may constitutes a restriction on the freedom of establishment within the meaning of the article 48 EC Treaty[181].

Indeed, in addition to their domestic accounts, non-resident companies are forced to keep separate Belgian GAAP accounts for their permanent establishments's activities in order to benefit from the Belgian NID regime. This additional requirement will result in additional costs for the permanent establishments and consequently for the non-resident companies, which is clearly a specific tax disadvantage for non-resident companies in comparison with Belgian companies[182].

Moreover, those additional costs are in contradiction with the idea of free choice between a branch (which is a form of permanent establishment) and a subsidiary[183]. One of the main reasons for setting up a branch instead of a subsidiary is clearly that the branch

177 *Ibid.*, par. 24 *et seq.*

178 *Ibid.*, par. 25.

179 *Ibid.*, par. 26.

180 *Ibid.*

181 Now TFEU, art. 56.

182 M. A. Caamano Anido and J. M. Calderon Carrero, "Accounting, the permanent establishment and EC law: the *Futura* Participations case", *EC Tax Review*, 1999, p. 31.

183 EC Treaty, art. 43, par. 1, 2nd indent (Now TFEU, art. 49, par. 1, 2nd indent).

is a more cost-effective from of establishment since it entails fewer costs. As highlighted by the ECJ in its *Avoir Fiscal* decision, the freedom of establishment includes the freedom *"to choose the appropriate legal form in which to pursue their activities in another Member State and that freedom of choice must not be limited by discriminatory tax provisions"*[184]. Therefore, the freedom to set up a branch may be restricted by those additional costs related to the additional Belgian GAAP requirement for Belgian permanent establishments of foreign companies.

3.3.2.2. Step 2: Justification by imperative reasons in the public interests

It is then necessary to examine whether this restriction may, nevertheless, be permissible, by analyzing whether "(...) *it pursues a legitimate objective compatible with the Treaty and is justified by imperative reasons in the public interests"*[185].

In the *Futura* case[186], the ECJ stated that the requirement of keeping a second set of accounts in order to obtain loss relief, which specifically affects companies having their seat in another Member State, constituted a restriction on the freedom of establishment[187]. However, it added that this restriction was justified because the measure pursued a legitimate aim compatible with the tax treaty, *i.e.* the effectiveness of a fiscal supervision[188]. The ECJ has clarified this justification ground[189] by stating that, in the absence of harmonization at the EU level of domestic rules relating to the determination of the basis of assessment to direct taxes, *"each Member State draws up its own rules governing the determination of profits, income, expenditure, deductions and exemptions as well as the amounts in respect of each of them which may be included in the calculation of taxable income or of losses which may be carried forward"*[190]. The ECJ added that *"a Member State may therefore*

184 *Avoir fiscal, supra,* fn n°102, par. 13.

185 See *inter alia Marks & Spencer, supra,* fn n°15, par. 35.

186 *Futura, supra,* fn n°102.

187 *Ibid.,* par. 26.

188 *Ibid.,* par. 31.

189 ECJ, 20 February 1979, C- 120/78, *Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein ['Cassis de Dijon'],* [1979] ECR 00649.

190 *Futura, supra,* fn n°102, par. 33.

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"[191]. In its *Baxter* decision, the ECJ also applied the concept of effectiveness of a fiscal supervision as a justification ground, by highlighting that *"a Member State may therefore apply measures which enable the amount of costs deductible in that State* (...) *to be ascertained clearly and precisely*"[192].

Based on this analysis, it could be argued, in the present issue, that the denial of the benefit from the NID regime to Belgian permanent establishments of foreign companies, which do not apply full Belgian GAAP, may also be justified by the effectiveness of a fiscal supervision, as described in the *Futura*[193] and *Baxter*[194] decisions. Indeed, it could be argued that the sole concern of the Belgian government, by putting such rule in place, is to ensure a correct application of the NID regime in accordance with the Belgian profit determination rules and, in particular, to determine clearly and precisely the amount of the NID which can be applied at the level of the Belgian permanent establishments.

3.3.2.3. Step 3: The proportionality test

It finally remains to examine whether the denial of the NID regime to Belgian permanent establishments of foreign companies which do not apply full Belgian GAAP goes beyond what is necessary to enable the amount of the NID which can be applied at the level of the permanent establishments to be clearly and precisely ascertained.

In this respect, the ECJ noted in its *Futura* decision[195] that a Member State "*may* (...) *require the non-resident taxpayer to demonstrate clearly and precisely that the amount of the losses which he claims to have incurred corresponds, under its domestic*

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191 *Ibid.,* par. 31.

192 ECJ, 8 July 1999, C-254/97, *Société Baxter, B. Braun Médical SA, Société Fresenius France and Laboratoires Bristol-Myers-Squibb SA v Premier Ministre, Ministère du Travail et des Affaires sociales, Ministère de l'Economie et des Finances and Ministère de l'Agriculture, de la Pêche et de l'Alimentation,* [1999] ECR I-04809.

193 *Futura, supra,* fn n°102.

194 *Baxter, supra,* fn n°191.

195 *Futura, supra,* fn n°102.

rules governing the calculation of income and losses which were applicable in the financial year concerned, to the amount of the losses actually incurred in that State by the taxpayer"[196].

Nevertheless, it added that the requirement of keeping a second set of accounts in order to obtain loss relief was a disproportionate response to enable the Luxembourg authorities to obtain the required information in order to determine "*the amount of losses actually incurred in Luxembourg by the taxpayer*"[197]. The ECJ, particularly, highlighted the fact that there were less restrictive means for the Luxembourg authorities to attain this objective, by stating that "(i)*n a situation such as that arising in this case, it is not essential that the means by which the non-resident taxpayer may demonstrate the amount of the losses he seeks to carry forward be limited to those provided for by Luxembourg law"*[198]. In this respect, the ECJ mentioned the Mutual assistance Directive under which a Member State can ask another Member State for assistance if they need information to enable them to effect a correct assessment of taxes on income.[199]

In conclusion, the ECJ agreed with the Luxembourg authorities on the point that the amount of losses, a taxpayer asks to carry forward, must be clearly and precisely determined. However, for the ECJ, "*provided that the taxpayer demonstrates, clearly and precisely, the amount of the losses concerned, the Luxembourg authorities cannot refuse to allow him to carry them forward on the ground that in the year concerned he had not kept and not held in Luxembourg proper accounts relating to his activities in that State"*[200].

According to the *Futura* decision[201], the Belgian authorities may thus, in the present issue, require the non-resident companies to provide with the correct figures to demonstrate the amount of NID

196 *Ibid.*, par. 43.

197 *Ibid.*, par. 39 ; see also O. THOMMES, "European Court of Justice Releases Branches of EU Companies from Duplication of Bookkeeping Requirements", *Intertax*,1997, p. 323.

198 *Futura, supra*, fn n°102 par. 40.

199 Council Directive 2004/56/EC of 21 April 2004 amending Directive 77/799/EEC concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation, certain excise duties and taxation of insurance premiums, *OJ* L 127, 29.4.2004, pp. 70–72.

200 *Ibid.*, par. 39.

201 *Ibid.*

to be deducted from the taxable income of their Belgian permanent establishments. As already mentioned[202], the NID regime is an innovative measure in international tax based on complicated computation rules and, in this respect, the Belgian GAAP requirement seems, in my opinion, to be the best method for determining, clearly and precisely, the NID basis of Belgian permanent establishments of foreign companies[203].

Nevertheless, it should be analyzed whether or not there are other less restrictive means available to obtain the same result. In this respect, it should be, firstly, noted that in the *Futura* decision[204], the ECJ did not provide with which any methods it considered appropriate to determine the amount of losses to be carried forward, instead of the requirement of keeping a second set of accounts. Consequently, as highlighted by Professor Miguel Angel Caamano Anido and by Professor José Manuel Calderon Carrero, this judgment may bring about *"a loss of legal security and a consequent increase in administrative discretion"*[205].

However, reference can then be made to the Belgian tax legislation[206], according which in the absence of appropriate bookkeeping evidence, taxation of foreign businesses operating in Belgium[207] may be determined by reference to the normal profits or earnings of at least three similar taxpayers and having regard, as appropriate, to the capital invested, the turnover, the number of workers, the source of power used, the rental value of land used, and any other relevant information[208]. It could, therefore, be argued that a similar method can be used to determine, clearly and precisely, the NID basis of Belgian permanent establishments of foreign

202 See point 2.2.1 of this paper.

203 ECJ, 17 July 1997, Case C-245/95, *GT-Link A/S v De Danske Statsbaner (DSB),* [1997] ECR I-04449, par. 42; see also M. A. Caamano Anido and J. M. Calderon Carrero, *op. cit*., p. 36.

204 *Futura, supra,* fn n°102.

205 *Ibid.*, p. 36.

206 BITC, art. 342.

207 This method was, firstly, applicable only to non-resident companies, but following the *Talotta* decision, the Belgium authorities amended the law, by applying this method irrespective of the taxpayer's residence. See ECJ, 22 March 2007, C-383/05, *Raffaele Talotta v Belgian State*, [2007] ECR I-02555.

208 L. Denys, "Belgium: The Concept of Permanent Establishment Revisited and Other Reflections Beyond", *Bulletin for International Taxation 8/9,* 2008, p. 443.

companies. In my opinion, this method is not sufficiently precise to establish, clearly and precisely, the NID amount which can be applied at the level of Belgian permanent establishments and a tax advantage such as the NID regime cannot be granted on the basis of the imprecise figures which arise from this method. In this respect, reference can also be made to the *Futura* decision according which the ECJ argued that "*the fact that a Member State allows a non-resident taxpayer to substantiate the amount of his taxable income on the basis of an apportionment of his total income does not mean that it is obliged to accept a calculation of the amount of losses to be carried forward made on the basis of an apportionment of total losses. Given that the apportionment method involves inaccuracies, a Member State is not under any obligation to determine the taxable base for a taxpayer by means of that method alone*"[209].

In addition, some may argue that there is another less restrictive mean which could used to obtain the same result in the form of an *ad hoc* determination of the NID basis. In this respect, according to the Belgian Supreme Court case-law[210], financial accounts with probative value may be used for the determination of the taxable base, even though accounting law (in the present issue, Belgian GAAP requirement) has not been fully complied with. In other words, the fact that accounting law has not been complied with does not take away the probative value of financial accounts when the same guarantees of correctness as the accounting rules have been provided. Furthermore, the Belgian authorities have adequate means available at the EU level to exercise sufficient control on the situation of the Belgian permanent establishments of EU companies. Under the Mutual assistance Directive[211], the Belgian authorities may indeed request another Member State for assistance if they need information to enable them to audit the correct application of the NID[212].

209 *Futura*, *supra*, fn n°102, par. 42.

210 Belgian Supreme Court, 10 March 1964, *Bull.* 417, p. 507, as referred to in Comm. BITC, n°340/11; see also T. AFSCHRIFT, *Bewijs in fiscal recht*, Larcier, Brussels, 2002, pp. 261-263.

211 Council Directive 2004/56/EC of 21 April 2004 amending Directive 77/799/EEC concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation, certain excise duties and taxation of insurance premiums, *OJ* L 127, 29.4.2004, pp. 70–72.

212 *Futura*, *supra*, fn n°102, par. 41.

In conclusion, it could be argued that, based on this analyze, the denial of the NID regime to Belgian permanent establishments of foreign companies which do not apply full Belgian GAAP would go beyond what is necessary to enable the amount of the NID which can be applied at the level of Belgian permanent establishments to be clearly and precisely ascertained. Nevertheless, in my opinion and due to complexity of this innovative regime, the Belgian GAAP requirement remains the most accurate method for determining, clearly and precisely, the NID basis of the Belgian permanent establishments of foreign companies.

4. Conclusion

It should be pointed out that the entire NID regime is not questioned in terms of compatibility with EU law, but only two specific aspects of this regime:

1) The legal exclusion from the NID computation of the net equity corresponding to the net value of branches or real estate located in treaty countries[213].

As already mentioned[214], this requirement may constitute an unjustified restriction on the freedom of establishment within the meaning of the article 48 EC Treaty[215] in the case of branches located in a EU/EEA Member State and in the case of real estate located in a EU/EEA Member State, if the real estate investment is actively managed in the same country. If this is not the case, this requirement may constitute an unjustified restriction on the free movement of capital within the meaning of article 56 EC Treaty[216].

In the framework of the infringement procedure opened by the EU Commission concerning this issue[217], most commentators have considered a change in Belgian legislation should be envisaged[218], before waiting whether or not the EU Commission decides to follow the proceeding with an eventual referral to the ECJ.

213 BITC, art. 205ter, §2 and §3.

214 See point 3.3.1 of this paper.

215 Now TFEU, art. 56.

216 Now TFEU, art. 63.

217 See the letter sent by the European Commission to the Belgian Government dated February 19, 2009, 2008/4335, C(2009) 0927.

218 D. Stevenson, "Commission criticises Belgium's notional interest deduction regime", *http://www.internationaltaxreview.com*, 24 February 2009 ; M. Dassesse, *op. cit.*, p. 5.

This illegal aspect of the NID regime could be indeed easily removed, without prejudicing its main objectives, by allowing the benefit from the NID regime to be claimed by a Belgian resident company in respect of its own net equity corresponding to the net value of branches or real estate located in treaty countries.[219]

In this respect, Pascal Van Hove, international tax partner at Deloitte in Belgium said that if the Belgian authorities *"bother to change legislation they can possibly do so without having a huge impact to the budget. The regime could be amended, for instance, so that in treaty situations granting notional interest deduction would only impact the calculation of the branch profit or loss under Belgian tax rules. This would not cause any stunning revolution, since, already to date, the amount of foreign-source profits exempt from tax in Belgium must be assessed on the basis of Belgian tax law. The granting of the notional interest deduction would just reduce the branch profit that qualifies for treaty exemption with the same amount. The impact would then be mostly limited to losses in treaty branches. These would be temporarily aggravated by granting notional interest deduction, but they are subject to recapture anyway*"[220].

2) The legal requirement for Belgian permanent establishments of foreign companies to apply full Belgian GAAP in order to benefit from the NID regime[221].

As already mentioned[222], this legal requirement may constitute a restriction on the freedom of establishment within the meaning of the article 48 EC Treaty[223] insofar as the Belgian permanent establishments of companies located in a EU/EEA Member State cannot benefit from the NID when they are able to provide the necessary proof to determine the NID basis using other means with probative value.
In this respect, even though the Belgian GAAP requirement remains, in my opinion, the most accurate method for determining, clearly and precisely, the NID basis of Belgian permanent establishments of foreign companies, a change in the Belgian tax legislation allowing less restrictive means to attain this objective might be envisaged in order to afford some legal security to foreign companies aiming to invest in Belgium through permanent establishments.

219 In the case of the net equity corresponding to the net value of branches or real estate actively managed in the country where it is situated, this amendment could be, however, limited to the EU/EEA Member States.

220 Stevenson, D., *op. cit.*

221 RD/BITC, art. 73/4*septies*, par. 1.

222 See point 3.3.2 of this paper.

223 Now TFEU, art. 56.