# SHORTER ARTICLES, COMMENTS AND NOTES

# Belgian Income Tax Treatment of Transactions Between Related Persons

The Belgian economy's heavy dependence on foreign trade, much of which is carried out between persons and companies related to one another, has caused Belgian tax authorities to become increasingly sensitive to the shifting of profits between related domestic and foreign enterprises for the purpose of minimizing tax liability.[1]

The basic source of law applicable to such transactions is the first paragraph of article 24 of the Belgian Income Tax Code which reads:

> When an enterprise established in Belgium finds itself directly or indirectly in a relationship of interdependence with respect to an establishment located abroad, all abnormal or gratuitous advantages which by means of this relationship are granted to the latter or to persons or enterprises with which it has common interests, are added to its own profits.[2]

The administrative interpretation of this statutory provision gives relatively little guidance as to how it will be applied. Quite clearly the Belgian approach has been to avoid lengthy and complicated regulations of the type which are to be found in the United States in support of Section 482 of the Internal Revenue Code. Moreover, the small number of reported cases demonstrates that most article 24 cases are decided on the administrative level and never get to the courts.

Most income tax treaties which Belgium has concluded with other countries contain provisions similar to Article 9 (1) of the Organization for Economic Co-operation and Development (OECD) Model Double Taxation Convention which provides as follows:

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[1]Sibille, *Les Relations d'affaires internationales et l'application de l'article 24 du Code des impôts sur les revenus,* [1973] REPERTOIRE FISCAL, No. 5843, at 261.

[2]Art. 24, ¶ 1, reads in French as follows:

> Lorsqu'une entreprise établie en Belgique se trouve directement ou indirectement dans des liens quelconques d'interdépendance a l'égard d'une entreprise établie a l'étranger, tous avantages anormaux ou bénévoles qu'en raison de ces liens elle consent à cette dernière ou à des personnes et entreprises ayant avec celle-ci des intérêts communs, sont ajoutés à ses propres bénéfices.

> Where
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> *a)* an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or
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> *b)* the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State,
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> and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.[3]

The Belgian Tax Administration in its official comments on the Belgian network of double taxation conventions has taken pains to point out that the treaties must not be considered in any manner to limit the scope of article 24, section 1.[4] Thus, even though the language of the treaty provisions on the taxation of related enterprises differs from article 24, the Belgian Tax Administration considers that they are intended to achieve the same result.

There are three conditions to the application of article 24.[5] First, the Belgian enterprise must find itself directly or indirectly in a relationship of interdependence with respect to a company located abroad; second, the Belgian enterprise must have granted abnormal or gratuitous advantages to the foreign related entity; and third, there must be a cause and effect between the relationship and the advantage granted to the foreign entity. Thus, unlike Internal Revenue Code Section 482, the Belgian rules in principle require that there be a multinational element.

It follows that in general terms the shifting of profits and expenses between two or more strictly national enterprises will not be covered by article 24.[6] Nonetheless, to further the general principles pertaining to the deductibility of expenses, there are limits to what a Belgian taxpayer can do to shift expenses to another Belgian taxpayer who has not effectively incurred them.[7] Moreover, article 53 of the Belgian Tax Code is intended to prevent a taxpayer from applying losses on its usual operations to profits resulting from

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[3]OECD COMMITTEE ON FISCAL AFFAIRS, ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT (Paris), MODEL DOUBLE TAXATION CONVENTION ON INCOME AND CAPITAL (1977). Art. 7(1) applies similar rules for allocating profits between a company located in one of the contracting States and a permanent establishment located in the other contracting State.

[4]COMMENTAIRE GÉNÉRAL DES CONVENTIONS PREVENTIVES DE LA DOUBLE IMPOSITION, ch. 9, ¶ 9/3.

[5]*Id.* ¶ 9/2

[6]*But see Compagnie belge transmarine,* Brussels Court of Appeal, October 16, 1971, cited in "Journal Pratique de Droit Fiscal" (1971) hereafter referred to as J.P.D.F. at page 295; confirmed Cass., September 20, 1972, Pas., 1973, I 72 and J.P.D.F. (1972), p. 292. This case involved two Belgian companies controlled by a third company located abroad. The courts found that, although the transaction involved two Belgian taxpayers, the true beneficiary was the foreign parent.

[7]BELGIAN INCOME TAX CODE art. 44.

the transfer to it of "abnormal or gratuitous advantages" from a related entity. This provision of the law was used in a well-known case to disallow the deduction of losses when a profitable activity of one Belgian company was transferred to another taxpayer which was in a loss position.[8]

## I. Definition of Related Entities

The language of article 24 envisages a wide range of relationships. The administrative commentaries confirm this approach.

First, the term "enterprise" includes both companies and individuals.[9] Moreover, the dependent relationship can be both direct and indirect. Thus, not only are parent-subsidiary relationships covered, the law also considers companies to be related where they have a common parent.[10] Belgian branches of foreign companies and foreign branches of Belgian companies are covered by the term "enterprise."[11]

The tax authorities will look to the facts in any given situation to determine whether there is a relationship of interdependence. An obvious legal relationship, such as where a foreign company owns a majority share interest in a Belgian company, would normally be determinative of the issue of interdependence. However, control may be deemed to exist over a Belgian company (or inversely by a Belgian company over a foreign company) where there is a common board of directors or where there is a close family relationship between management of the two companies.[12]

Interestingly, a relationship of interdependence may be deemed to exist even where there is no structural relationship between the two companies but where on a strictly economic basis one of the two companies obviously depends upon the other. Thus, the Belgian Supreme Court concluded that there was interdependence where a Belgian distributor was the exclusive Belgian representative for goods produced by a Dutch manufacturer of textiles, the contract prohibited the Belgian company from selling other identical products, prices and conditions of sale were determined by the principal distributor, the management of the Belgian company was in the hands of a person who had formerly been associated with the Dutch manufacturer, and the shares were held by a former representative of the Dutch distributor.[13]

## II. Abnormal or Gratuitous Advantages

Basically, the Belgian Tax Administration considers that there have been abnormal or gratuitous advantages where a foreign company has been

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[8] *Société anonyme Craft*, Cass, April 26, 1966, Pas., 1966, I, 1081.

[9] COMMENTAIRE DU CODE DES IMPOTS SUR LES REVENUS, ¶ 24/3 [hereinafter cited as COMM. I. R.].

[10] *Id.* ¶ 24/3

[11] *Id.* ¶ 24/2

[12] *Id.* ¶ 24/5

[13] *Flagship*, April 9, 1968, Pas. [1969] I/Cass. 1968, I, 978.

enriched by a Belgian company and there has either been no consideration for such enrichment or the consideration is inadequate.[14]

It is, moreover, necessary that these advantages were granted to the foreign company as a result of their interrelationship. Thus, the tax authorities are not authorized to intervene in a transaction between two unrelated entities merely because it appears the transaction was disadvantageous to the Belgian company and advantageous to the foreign entity.

Belgian statutory provisions and administrative regulations do not refer to an arm's length standard as such. From a purely doctrinal point of view, it is possible that there would be circumstances where the transaction, although acceptable if carried out by independent parties, would nevertheless be deemed to have resulted in an abnormal advantage to the foreign entity when carried out by related parties.[15]

The fact that the parties to a particular transaction did not intend to avoid Belgian taxes would normally not be determinative. There is reason to think that, as in the United States, Belgian tax authorities will not be persuaded by legitimate business reasons for a pricing scheme where the transaction under consideration would not be normal had it been carried out between unrelated entities.[16]

The financial contexts in which problems have arisen in Belgium are familiar to United States readers and include loans, services, royalties, and transfers of intangible property, purchases, and sales. A brief discussion of each of these areas follows.

### A. *Loans*

Interest-free loans entered into by a Belgian company with a related foreign company have on several occasions been held to be an abnormal advantage which would result in an adjustment of the Belgian company's taxable income.[17] Moreover, waiver or forgiveness of a loan by a Belgian lender to a foreign related debtor will usually result in an adjustment to the Belgian taxpayer's income. The particular circumstances of the case would determine the amount added to taxable income.[18]

Loans where the interest charged by the Belgian partner to a related entity outside of Belgium is deemed to be inadequate will likewise be subject to attack, though the courts have been prepared to take a position independent of the Tax Administration on this matter.[19] Similarly, interest rates which are

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[14]Sibille, *supra* note 1, at 268-69.

[15]JANS, LES TRANSFERTS INDIRECTES DE BÉNÉFICES ENTRE SOCIÉTÉS INTERDÉPENDANTES 94 (1976) (Establissements Emile Bruylant, Brussels)

[16]*Id.* at 115.

[17]*See* cases cited in COM. I. R., *supra* note 9, at ¶ 24/11.

[18]Judgment of Feb. 11, 1977, Cour d'appel, Brussels, cited in [1978] JOURNAL DE DROIT FISCAL 187.

[19]*See, e.g., Sandeman,* Judgment of Nov. 15, 1962, Cour d'appel, Brussels, *cited in* [1963] JOURNAL PRATIQUE DE DROIT FISCAL 44.

deemed excessive when charged by a foreign company to a related Belgian entity may be disallowed in part as a nondeductible expense.[20]

It should be pointed out that there is no equivalent under Belgian rules to the safe-haven guidelines to be found in the regulations under section 482 of the Internal Revenue Code. However, as a matter of principle, pursuant to article 50 of the Belgian Income Tax Code, any interest rate paid by a Belgian company to a third party (whether or not related) will be disallowed to the extent that it exceeds 9 percent or three points above the Belgian discount rate. Article 24 may, of course, still be applied where the interest rate paid by the Belgian company to a foreign related entity is less than 9 percent but is nevertheless deemed to be an abnormal advantage to the foreign entity.

### B. *Services and Management Fees*

Belgian courts have, on several occasions, examined the deductibility of service fees paid by a Belgian company to a related foreign entity. In some instances the Belgian taxpayer has prevailed before the courts.[21] In those cases where the Belgian taxpayer has lost, it was clear that fees paid to or on behalf of the foreign company have not resulted in an appropriate remuneration to the Belgian company.[22]

In principle, the Belgian taxpayer would have to show that the fees paid correspond to services which have been effectively rendered and which are of use to the Belgian company and that the amounts in question are normal charges for the type of services which have been rendered.

One area which has in the past caused some difficulty concerns the fees paid by the Belgian company to a firm of auditors. Frequently, a Belgian affiliate of a foreign company will resort to the services of the local branch of a worldwide accounting firm and the question then arises whether the services are for the benefit of the foreign company or for the Belgian subsidiary. At the moment, it would appear the deduction of fees for auditing services which have been ordered by the Board of Directors of the Belgian company will be accepted by Belgian tax authorities.[23]

### C. *Royalties and Transfers of Intangible Property*

The courts have consistently applied the general principle that royalties payable by a Belgian licensee to a related company located abroad cannot exceed an adequate compensation to the licensor.[24] The taxpayer must use good sense in determining the amount of royalties that can be paid since there are no guidelines as to what will constitute adequate remuneration.

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[20]JANS, *supra* note 15, at 161.

[21]Judgment of Mar. 4, 1965, Cour d'appel, Brussels, *cited in* [1966] REVUE FISCALE 203.

[22]*Albert Knapen,* Judgment of Mar. 27, 1975, Cour d'appel, Liege, *cited in* [1976] JOURNAL DE DROIT FISCAL 273.

[23]JANS, *supra* note 15, at 174–75.

[24]*See* Warner Brothers, Judgment of Mar. 22, 1971, Cour d'appel, Brussels, [1971] JOURNAL DE DROIT FISCAL 105.

In the area of trademarks, the courts have ruled that a royalty to the foreign related licensor will be permitted where the Belgian licensee manufactures the trademarked goods and benefits from the licensor's know-how and experience. On the other hand, no royalty would be allowed where the Belgian licensee is nothing more than a distributor for goods manufactured and packaged by the foreign licensor.[25] If the foreign licensor permits the Belgian licensee to use its trademark as part of the corporate name, a royalty will almost certainly be disallowed.[26]

In principle, the same rules will apply to patent licenses. There is a 1948 decision decided under a predecessor provision to article 24 which disallowed a royalty of 8 percent to 10 percent based on turnover on the theory that the licensor which owned a majority interest in the licensee was in fact siphoning off its profit in the form of royalties rather than as dividends.[27] This case does not appear to have been followed by later decisions.

D. *Sale of Property*

There are only a few reported cases pertaining to the sale of goods to a related enterprise at a price which is too low or, conversely, the purchase of goods from a related enterprise at a price which is deemed to be too high.[28] In one of the more recent cases on the subject, shares held by the taxpayer in its portfolio at book value were sold to a related company located abroad. The true value was deemed to be far in excess of book value and the sale was held to be a transaction covered by article 24.[29]

A controversy has arisen over similar transactions where consideration was in the form of shares rather than cash. Thus, where Banque Lambert transferred a portfolio investment to its Luxembourg holding company in exchange for shares the nominal value of which was substantially less than the actual value of the investment, the taxing authority found there had been a transfer of hidden reserves from the Belgian bank to the Luxembourg holding company.[30] The problem with this interpretation is that although the face value of the shares of the Luxembourg holding company was, indeed, lower than the value of the investment transferred, the actual value of the shares of the Luxembourg holding company was substantially in excess of par and equivalent in value to the shares so transferred. Several commentators have concluded that the decision is erroneous.[31]

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[25]*CIBA*, Judgment of June 21, 1958, Cour d'appel, Brussels, *cited in* [1959] REVUE FISCALE 118.

[26]*Société coopérative Auto Inspection Bureau Veritas*, Judgment of Oct. 4, 1972, Cour de'appel, Brussels, *cited in* [1972] JOURNAL PRATIQUE DE DROIT FISCAL 311.

[27]*Fichet*, Judgment of Apr. 27, 1948, Cour d'appel, Brussels, *citvd in* [1948] REVUE FISCALE 467, *aff'd Cass. May 23, 1950, Pas., 1950 I, p 675*

[28]*See* cases cited in COM. I. R., *supra* note 9, at ¶ 24/11.

[29]*Compagnie belge transmarine, supra* note 6.

[30]*Banque Lambert*, Cass., Nov. 3, 1965, Pas., 1956, I, p 290

[31]*See* JANS, *supra* note 15, at 88-89.

## III. Adjustments and Correlative Adjustments

As a general principle, the burden of proving the abnormal character of an advantage which has been granted to a foreign taxpayer is upon the tax administration. However, as a practical matter, once the Tax Administration has determined that such an advantage has been granted, the burden of proof to the contrary would appear to shift back to the taxpayer.

The advantage which the Belgian taxpayer is deemed to have granted to a foreign related entity must be added back to its taxable profits. The administrative commentaries point out that the word "advantage" is not the same as "profits."[32] This means, for example, that statutory limitations on the taxation of unrealized capital gains will not be applicable.

The Belgian Tax Administration is not concerned with correlative adjustments to the foreign enterprise's taxable income. Article 24 is applicable only to enterprises located in Belgium and Belgian tax authorities are in no way concerned with the results which any adjustment may have on a foreign entity,[33] The only relief available, therefore, is through application by the foreign taxpayer to his own tax authorities or through the appropriate provisions of an income tax treaty.

The latest version of the OECD model income tax treaty does include a provision which would institute a mechanism for correlative adjustments;[34] but Belgium has not yet seen fit to incorporate this provision in its tax treaties and the Belgian administrative commentaries on tax treaties are based on the 1963 version of the model income tax treaty.

## IV. Special Situations

Belgium has extended its treatment of transactions between related entities to operations where the parties may or may not be related but one of them is located in a tax-haven jurisdiction. The second paragraph of article 24 of the Income Tax Code provides that the provisions of the first paragraph are "applicable to abnormal or gratuitous advantages accorded to a person or enterprise which, by reason of the provisions of the legislation in the country where it is established, such person or enterprise is subject to a tax régime notably more advantageous than that to which the enterprise located in Belgium is subject." The administrative commentaries furnish a list of the known tax havens ranging from the Netherlands Antilles to the New Hebrides.[35]

Article 46 of the Code provides that the burden of proof is on the taxpayer to show the deductibility of interest, royalties, and service fees paid to foreign holding companies or to other persons located in tax-haven jurisdictions. Article 250 of the Code provides a similar solution to the sale, transfer or

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[32]COM. I. R., *supra* note 9, at ¶ 24/17; *Compagnie belge transmarine,* Cass., Sept. 20, 1972, Pas., 1973 I, p. 72 .

[33]Sibille, *supra* note 1, at 262.

[34]MODEL DOUBLE TAXATION CONVENTION ON INCOME AND CAPITAL, *supra* note 3, art. 9(2).

[35]COM. I. R., *supra* note 9, ¶¶ 24/23, 44/67.5.

contribution of securities and other intangible property to foreign holding companies or other persons located in tax-haven jurisdictions.

Thus, transactions between related entities may be doubly suspect where one of the parties is located in a tax haven jurisdiction or a country which taxes the foreign entity in a manner which is substantially more favorable than Belgium.

### V. Hints for Corporate Planners

Experience has demonstrated that transactions between related companies must be given careful thought and planning and be supported by adequate documentation. Wherever possible the parties should enter into contractual arrangements which detail the nature of the transaction and justify the consideration for the sale of goods, services, or other operations.

Although contracts between related entities may be viewed by some as self-serving, they may, nevertheless, be enormously helpful in dealing with tax authorities. They also serve the purpose of requiring the parties to give adequate thought to their arrangements before putting them into effect. Moreover, as so often happens in the case of multinational enterprises, the people who originally designed the relationship between the entities concerned are no longer available to explain why a particular route was chosen and how compensation was computed. Under the circumstances, well-documented decisions will enable their successors to plan further and to handle any problem which arises.

The important point to remember, particularly for a country such as Belgium which relies on an *ad hoc* and generally good sense approach to the treatment of transactions between related entities, is that the taxpayer should be able to demonstrate why a particular price, royalty, interest rate or other consideration was chosen. Whenever possible, planners should avoid percentage payments based on turnover. Thus, it is acceptable to charge a royalty based on sales for the use of a patent; but management services are more likely to be accepted where the fee is based on demonstrable services with time sheets, expense vouchers, and other documentation available to support the charge.

### Conclusion

There is no doubt that as government financial requirements continue to grow by leaps and bounds, the need to find new sources of revenue will also increase. One relatively easy source which does not require higher tax rates or the creation of new taxes is the multinational company or groups of companies whose transactions can be closely scrutinized for failure to live up to an arm's length standard. Belgium has not escaped this trend, and it can be expected that in future years transactions between related companies will be subjected to ever-increasing scrutiny.

ERIC OSTERWEIL