HARMFUL TAX COMPETITION:

BELGIAN MEASURES CONSIDERED TAX HARMFUL
I. INTRODUCTION

A. Background : the international fight against harmful tax competition

On December 1, 1997, the Ministers of Finance of the EU Member States adopted a "Code of Conduct", designed to eliminate preferential tax regimes which are "harmful" to other States.

On November 29, 1999, the so-called Code of Conduct Group presented its final Report on harmful tax regimes in place within the Member States and their dependent countries. This report contains a list of 66 tax measures considered as being "harmful".

In parallel, the Committee on Fiscal Affairs of the OECD had already undertaken a similar study and produced a report on "Harmful Tax Competition". A progress report was issued in June 2000.

After a short review of the principles underlying the Code of Conduct and the OECD report, we will examine all the Belgian tax measures which are identified as being harmful by the report of the Code of Conduct Group.

B. The EU Code of Conduct

Under the EU Code of Conduct, tax measures which provide for a significantly lower level of taxation than the levels which generally apply in the Member State in question are considered as potentially harmful, whether the level of taxation is the result of the rate, the base or any other factor.

The following criteria are, among others, to be taken into account:

1. Facilities are granted only to non-residents or to transactions with non-residents.
2. Advantages granted have no impact on the national tax base.
3. Lack of economic activity does not prevent the granting of advantages.
4. The regime departs from internationally accepted (OECD) principles.
5. Admission to the regime lacks transparency.
Following a standstill and an exchange of mutual information on each other’s regimes between Member States, a Working Group will assess their “harmfulness”. Dismantlement will follow two years or a longer period if warranted by expectations of users.

C. The OECD report on Harmful Tax Competition

The OECD report lists identifying factors of harmful tax regimes in more detail.

The main identifying factors are the following:

1. No or low effective tax rates because of a low schedule rate or the definition of the tax base;
2. Ring-fencing by an exclusion of resident taxpayers from the benefits or a prohibition on enterprises benefiting from the regime from operating in the domestic market;
3. Lack of transparency secured by:
   . favourable administrative rulings, except if they are consistent with statutory law and if criteria are known and publicised;
   . special administrative practices contrary to statutory procedures;
   . lack of enforcement of the law, for instance because of a lax tax audit policy;
4. Lack of effective exchange of information, evidenced by the failure to notify the foreign authority of the regime granted to a foreign taxpayer.

Additional identifying factors are:

1. An artificial definition of tax base, which is the result of:
   . unconditional rules for the avoidance of double taxation (participation exemption, capital gains rules, full credit);
   . a deduction for costs when income is not taxable;
   . a deduction for expenses assumed not actually but incurred;
   . overly generous reserve charges;
   . a restriction of the tax base for particular operations.
   An example is the application of a margin to expenses or revenue and the exclusion of a portion of such expenses or revenue from calculation, especially if it is non-transparent;
2. The failure to adhere to international transfer pricing principles (1992 – OECD guidelines), for example by an improper use of safe harbours;
3. The exemption of foreign source income;
4. A negotiable tax rate or base;
5. Secrecy provisions;
6. A wide network of tax treaties used in connection with the regime;
7. The promotion of tax minimisation vehicles;
8. The encouragement of the establishment of purely tax-driven operations.

In order to assess the economic effects of a preferential tax regime, the OECD looks at a possible shifting of economic activity from country to country as opposed to the generation of new activity. Are the presence and the level of activity commensurate with the investment or income? Is tax the primary motivation for the location of the activity?

The OECD lists a variety of counteracting measures which may be employed by countries to eliminate harmful taxation competition.

Under domestic legislation the following can be introduced:

1. Controlled Foreign Corporations rules
2. Foreign investment fund rules
3. Restrictions on participation exemption for favoured income.
4. Reporting rules for foreign transactions
5. Publicity of conditions for the granting of tax rulings
6. Transfer pricing rules
7. Greater access for tax authorities to banking information.

Under Tax Treaties the following can be considered:

8. Amendment of Art. 26 of the OECD Model Tax Convention to extend it to taxes not covered by the Convention;
9. Information provided on preferential tax regimes favoured;
10. Limitation on benefits: denial of treaty benefits to favoured entities;
11. Compatibility of domestic anti-abuse rules with tax treaties: the OECD commentary should be clarified in this respect;
12. The drafting of a list of exclusions from treaties, to be prepared by an OECD Committee;
13. Refusal to enter into treaties with tax havens except if they include safeguards preventing their use to the detriment of other countries;
13. Joint audits;
14. Mutual assistance in the recovery of tax claims;

Within the framework of international co-operation, the OECD proposes various measures, in particular the approval of guidelines on harmful preferential tax regimes, which a Forum on Harmful Tax Measures would implement. Those proposed guidelines provide for countries to:

a. refrain from adopting or extending harmful tax practices;
b. undertake a review of national tax regimes and practices and report to the Forum within two years;
c. remove identified harmful measures within five years extended to 2005 for taxpayers benefiting from any such measure in 2000;
d. request examination by the Forum of measures not included in the self-review;
e. co-ordinate national and treaty responses vis-à-vis other countries;
f. make efforts to associate non-OECD member countries with the guidelines.

The Forum would also produce a list of tax havens and OECD countries would use their political links with tax havens to assist in the elimination of damaging tax regimes.

Further topics to be discussed within the Forum will include:

1. The restriction of tax deductions for payments to tax haven entities;
2. Withholding taxes on payments to residents of countries engaging in harmful tax competition;
3. New residence rules, possibly based on shareholder control;
4. Transfer pricing rules;
5. Thin capitalisation rules;
6. The tax regulation of financial innovation;
7. Non-tax measures.

D. Tax competition in general

The elimination of harmful tax competition is what is left of the objective of tax harmonisation, after its erosion by the principle of subsidiarity.

Liberal economists consider that the efforts made with the objective of achieving even a limited tax harmonisation, including also the imposition of a uniform withholding tax on income from investment, is nothing but a defence of the last monopoly existing in the
common market: the monopoly of nation States to tax and use without an efficiency control the tax money of their citizens. According to such economists, tax competition should be allowed to develop: the market will judge the respective packages of taxes and public services provided in each country\textsuperscript{vi}. This thinking had already been advocated in connection with VAT rates.

Is there a "fair" tax competition, consisting in an overall lowering of tax rates, coupled with a broadening of the tax base, and a "bad" tax competition, aimed at attracting certain types of activities away from other countries?

Recently, side-effects of a lowering of corporate tax rates in a country using the foreign tax credit as a method to avoid international double taxation was highlighted by studying the aftermath of the US Tax Reform Act of 1986 the lowering of tax rates - in the presence of the foreign tax credit -, instead of leading to a repatriation of investments, induced a flow of outbound foreign direct investment. Many firms moved to an excess foreign tax credit position and were led to invest in low tax countries to create averaging – check: the low tax rate at home in the US made a move to a neutral credit position unlikely.

The transfer of profits abroad, e.g. by transfer pricing, became less attractive when the foreign tax rate exceeded the new 34 % US corporate tax rate. At the same time, base broadening increased the effective tax rate on new investment at home in the US, thereby increasing the attractiveness of investment abroad\textsuperscript{vii}.

E. State aid

The European Commission has the power to request the withdrawal and repayment of any State aid, including State aids granted in the form of a preferential tax regime\textsuperscript{viii}. The Belgian co-ordination centre rules were scrutinised in this respect and a cost-plus had to be substituted for the full exemption initially contemplated.

The Commission issued, pursuant to the adoption of the EU Code of Conduct, a notice on the application of the State aid rules to measures relating to direct business taxation. This notice makes clear that State aids in tax form, as all aids, are prohibited only if they distort competition or favour certain undertakings or the production of certain goods. Non-selective measures will generally not have such effect.
An exemption to this prohibition on State aids may be justified for a differential measure by "the nature or general scheme" of the tax system: does the measure derive directly from the base principles of the tax system of the State concerned? The Commission points out that the purpose of a tax system is to collect revenue. Certain exceptions are therefore difficult to justify by the logic of a tax system. This is the case if a favourable tax treatment is granted to head offices or to firms providing certain services, for example, financial services within a group\textsuperscript{x}.

The qualification of a tax measure under the EU Code of Conduct does not prevent possible qualification as a State aid\textsuperscript{y}.

II. BELGIAN HARMFUL TAX MEASURES

A. Co-ordination centres

1. Conditions Attached

According to Royal Decree nr 187 of 1984, the co-ordination centres (Belgian incorporated companies or branch offices of foreign companies) may carry on financial and administrative co-ordination activities of multinational businesses. However, corporate groups of the credit, banking and insurance sectors (as defined by the Belgian Income Tax Code) are precluded from creating co-ordination centres.

A co-ordination centre must form part of a multinational group, with consolidated capital and reserves of at least 24.789.352,48 € (BEF 1 billion) and a turnover of at least 247.893.524,77 € (BEF10 billion). A group includes all companies in which the common shareholdings (either direct or indirect) represent at least 20 % of the share capital. In order for the group to be considered as multinational, all of the following conditions must be met:

- The net equity of the group located outside the country of origin of the group should amount to at least 12.394.676,24 € (BEF 5 billion) or at least 20 % of the consolidated net equity of the group;
- As of the beginning of the second calendar year preceding the co-ordination centre's application (and without interruption) the group must have a subsidiary in
at least four different countries other than the country of origin of the group
(branch offices do not qualify as subsidiaries in this respect) ;

- The group must realise at least 123,946,762.39 € (BEF 5 billion) or at least 20 %
of its consolidated turnover outside its country of origin.

The co-ordination centre may conduct only a number of authorised activities, which
should be limited to intra-group transactions. Therefore the group concept is relevant not
only in respect of meeting the criteria of size, but also to determine the scope of the
authorised activities. As to the nature of the authorised activities, they can be divided into
two groups :

1. Activities of a preparatory and auxiliary nature ; including sales promotion and
   advertising, collection and dissemination of information, scientific research, and
   relations with national and international government institutions ;

2. Activities going beyond the "preparatory and auxiliary" concept ; including,
   insurance and re-insurance, the centralising of financial operations (for example,
   re-invoicing, factoring, financial leasing and financing) the hedging of foreign
   exchange risks and the centralising of accounting, administration and data
   processing.

None of the activities of the co-ordination centre should be extended to the activities that
constitute the commercial operations of the group. All activities of the co-ordination
centre should be carried out for the sole benefit of the other members of the group, i.e.
the co-ordination centre should never render services to third parties.

The co-ordination centre may not acquire shares in other companies, nor can it issue
loans represented by securities or commercial bills of exchange with a term exceeding
one year. An exception, however, may be introduced by a Royal Decree for securities in
foreign currencies placed abroad, provided that these securities are not subscribed by
private persons resident in Belgium or by non-profit organisations taxable in Belgium.

The co-ordination centre must employ in Belgium at least ten full-time employees, who
are subject to the Belgian social security system, within two years from the
commencement of its activities.

Finally, the co-ordination centre should be approved as such by the Belgian authorities
following the filing of a special application request with the Belgian Ministry of Finance.
2. Tax Benefits

Belgian co-ordination centres are liable to corporate income tax at the normal (40.17 %) rate, but (instead of the actual profits as shown in its financial statements) only to a notional tax base determined as a percentage of certain operating costs incurred by them. Certain items, such as personnel costs, financing costs and taxation are excluded from this base.

The percentage depends on the mark-up charged to the affiliated group companies and on the type and nature of the co-ordination centre's activities. In the absence of objective criteria, the mark-up percentage will be fixed at 8 %.

Incorporation of a co-ordination centre is exempt from the capital registration tax of 0.5%. The co-ordination centre is not liable to pay immovable prepayment (an income tax on the deemed net rental income of the property) on Belgian real estate owned by it.

A special annual tax of 9,915.74 € (BEF 400,000) per employee is payable, however with a maximum of 99,157.41 € (BEF 4 million).

All payments of dividends, interests and royalties made by the co-ordination centre are exempt from Belgian withholding taxes. Interests paid to individuals or legal entities subject to tax in Belgium will not benefit from this exemption. The credits for interest and dividends from the co-ordination centre are restricted to the extent that the loans or paid-up share capital are used by the co-ordination centre or a group member to finance investments in new tangible fixed assets or capitalised research and development expenditure in Belgium. Additionally, the rights to use the new tangible fixed assets should not be transferred to parties other than Belgian members of the group.

3. Evaluation

The Belgian co-ordination centres are considered as harmful because they are taxed on a fixed mark-up which is applied on a reduced tax base (only certain operating expenses of the centre are taken into account). There is also a requirement that they be part of an international group.

Various answers have been put forward in defence of co-ordination centres.
a. **Ring-fencing**

A first criterion used to assess the harmful nature of a preferential tax regime is "ring-fencing", an expression which brings to mind the border between the North Sea oil fields and the mainland for purposes of applying respectively petroleum revenue tax and the standard corporate tax.

Two types of ring-fencing are conceivable.

Under a first approach, the preferential tax regime would be available only to non-residents.

This is clearly not the case with regard to the regime applying to Belgian co-ordination centres. Belgian companies may participate in the creation of a co-ordination centre as shareholders and are included within the number of subsidiaries or the turnover and capital criteria making the group eligible as the initiator of a co-ordination centre.

The tax base for which the cost plus system is substituted includes Belgian source as well as foreign source income.

Treasury investments are excluded from the activities which may be carried on by a co-ordination centre when they are financed by the capital of the centre and when such capital has been contributed by group members which borrowed funds, if the interest on the loan is deducted "according to Article 44 of the Income Tax Code", i.e. deducted by a Belgian taxpayer, whether a Belgian company or the Belgian permanent establishment of a foreign company.

This provision, aimed at preventing a "crucible effect", under which taxable interest on standard deposits or short-turn investments unrelated to the needs of the group is converted into dividends for group members enjoying the participation exemption, may have to be reconsidered. Should a foreign tax base be protected as well or should this be left to foreign tax legislation?

A second type of ring-fencing insulates the domestic economy from the effects of the regime by prohibiting local enterprises from entering into transactions with the favoured entity. Belgian taxpayers, members of the group, are in no way forbidden from entering into service or financing agreements with the co-ordination centre of the group.
A second criterion which would disqualify a preferential tax regime under the Code of Conduct is its availability, even in the absence of any real economic activity.

The Belgian government has taken care to impose as a condition of the co-ordination centre status the obligation to employ within two years of establishment at least ten staff members representing an effective addition to the labour force of the group.

Restrictions built into the system may also be considered as gearing it towards an effective economic activity within an industrial or trading group. Banks and insurance companies may not be members of the group. A company may belong only to one group. A centre may not hold shares and is prevented from playing the role of a holding company.

In its financing activities, the centre will be economically at risk.

The OECD report focuses on economic activity as a criterion not for qualifying a preferential tax regime as harmful but for assessing the effects of harmfulness.

Three questions are raised.

Is the presence and the level of activity commensurate with investment or income? This will be the case for co-ordination centres, as their funds have to be used in the group and not in short-term investments, as a base erosion device, with the caveat that the prohibition be generalised to non-resident taxpayers.

Did the tax regime shift activity from one country to another? The regime may have shifted financing from tax haven financial subsidiaries to Belgium.

Is the preferential tax regime the primary motive for the siting of the activity in Belgium?

The aim of the government was to promote in Belgium a host of financial activities which were already largely present. Belgium was also a common European centre for company headquarters.

b. Departure from international principles of taxation

A main criterion of harmfulness for the EU Code of Conduct and an ancillary factor for the OECD report is the departure from internationally generally accepted principles in the
determination of profits derived from internal activities of a multinational group. By internationally accepted principles, the text refers in particular to the Transfer Pricing Guidelines determining arm’s length terms of business between related entities.

A co-ordination centre is taxable, in addition to its cost-plus base, on any abnormal or benevolous advantages granted to it, whether by a Belgian or a foreign group member. The use of overly generous transfer pricing is thereby discouraged. Tax audits have recently scrutinised the interest margin of centres and attempted to tax margins deemed excessive.

The OECD report also considers as a deviation from the Transfer Pricing Guidelines an excess allocation of earnings to a firm which engages in no activity or in an activity which, if not undertaken by a legally independent company, would not constitute a permanent establishment\textsuperscript{10}.

The first list of activities which a co-ordination centre may undertake includes these which would generally be of a preparatory or ancillary nature according to Article 5 of the OECD Model Treaty and would therefore not create a permanent establishment if the activity were exercised in a branch form. Indeed, the centre may be in the form of either a branch of a foreign company or a Belgian company; although the form of a Belgian company is generally preferred.

It is doubtful whether such an extension remains within the ambit of OECD principles. Nothing in such principles limits the right of a country to deal with its own corporate bodies as taxpayers.

If the centre was the unindependent subsidiary where the activity of a parent or even of another group member were carried out, it could be considered a permanent establishment of such principal. OECD principles do not go beyond this.

c. Lack of transparency

The final factor indicative of a harmful tax regime as contained in the EU Code of Conduct and a key factor in the OECD report is a lack of transparency, especially when legal requirements are applied in a lax and secretive way by the tax administration. Secret rulings, special administrative practices, non enforcement of the law are examples of such a lack of transparency in the view of the OECD.
The Belgian co-ordination centres regime cannot be found at fault in this respect. Conditions of its application are laid down in legislation and in an administrative circular. Approval is granted to each centre by a Royal Decree on the basis of a detailed application. Names of centres are published. Audits are entrusted to a special tax unit, which is known to be active and rigorous.

When the OECD mentions lack of effective exchange of information as an additional key factor of blacklisting, it will suffice to say that Belgium considers tax treaties to apply to co-ordination centres and exchanges information without any restriction. The same is true pursuant to the domestic provisions implementing the EU Directive on exchange of information.

The OECD lists as an additional factor the access to a wide network of tax treaties, opening up the benefits of preferential tax regimes. The deductibility of payments made to co-ordination centres is a matter of general tax law, not of treaty law.

Only the reduction or waiver of a withholding tax on interest or royalties may be the result of a treaty. This leads us to a discussion of limitation on benefits clause or, as the OECD puts it, to contemplating more extensive exclusion clauses in treaties.

d. Artificial definition of the tax base (OECD)

The first ancillary factor in the list of harmfulness factors according to OECD deserves discussion: is there an artificial definition of the tax base of co-ordination centres?

The OECD cites here provisions applying a margin to certain expenses or to certain revenue while at the same time excluding a portion of those expenses or of that revenue when calculating the margin.xii

It is true that, when calculating the cost plus tax base of a co-ordination centre, personnel and financial expenses are excluded, leaving only operating expenses as a tax base. Amendments may be requested there.

e. Counteracting measures
When it comes to counteracting tax competition, the first measure on the OECD list is Controlled Foreign Corporation legislation.

Nothing prevents the application of such legislation to a co-ordination centre\textsuperscript{viii}.

In its report on Controlled Foreign Company Legislation\textsuperscript{xiv}, the OECD states that interest received by finance subsidiaries are treated as active or passive income depending on national legislation. Sometimes, interest paid by operating companies on funds used in its activities is not considered as passive income. According to a study cited with approval by OECD, it should not be\textsuperscript{xv}.

Similarly, service fees are often considered as active income, whereas rental payments are considered as passive\textsuperscript{xvi}.

Ireland already announced its decision to substitute for its present regime a general lowering of its corporate tax rate to 12.5 % in 2002\textsuperscript{xvii}. The initial 32 % rate will be lowered by 4 % annually.

It is expected that Belgium will modify its co-ordination centre regime, applying possibly the cost plus percentage to full cost incurred by the centre.

The European Commission has proposed to Belgium to adapt its regime of co-ordination centres to bring it into conformity with the Treaty. This means that the Commission considers the regime to be a form of prohibited State aid.

If Belgium were not complying, the Commission could open the procedure of formal inquiry\textsuperscript{xviii}. Such an inquiry has now been initiated.

\textbf{B. Distribution Centres}

\textbf{1. Conditions Attached}

According to a circular of 30 November 1994, the distribution centre\textsuperscript{xix} regime is available for existing or newly incorporated Belgian companies (or a Belgian branch of a foreign corporation). There are no minimum employment or turnover requirements but in order to qualify for the tax benefits provided for in the relevant Tax Circular, the distribution centre must be a part of a group of companies.
The permitted activities of a distribution centre are restricted to comprise the exercise of the following:

- The purchase of raw materials and supplies, finished products and merchandise in the centre's own name or in the name and for the account of the group for which they are destined;
- The storage, management and packaging of raw materials and supplies, finished products and merchandise;
- Receiving orders from non-members of the group as well as drawing up and sending order confirmations without acceptance of the orders by the distribution centre;
- The sale and/or transport and delivery of the raw materials and supplies, finished products and merchandise to companies of the group;
- The transport and delivery of the raw materials and supplies, finished products and merchandise to non-members of the group for the account of the companies within the group;
- Preparation and distribution of invoices, taking into account that, as far as sales to non-members of the group is concerned, invoices must be drawn up in the name and for the account of the members of the group who have purchased the goods from the distribution centre;
- Performing financial, banking, VAT, customs, excise and administrative formalities related to the permitted activities.

This list is not exhaustive as other activities can be accepted when applying for the special distribution centre status.

2. Tax Benefits

In principle, a distribution centre is subject to the ordinary corporate tax (chargeable at 40.17%) but the prices charged to affiliated companies are regarded as being at arm's length in so far as its turnover is 105% or more of all costs borne by it, except for:

- The purchase price of raw materials and supplies, finished products and merchandise which are sold during the taxable period;
- The non-deductible Belgian income taxes;
- Other disallowed expenses;
- The reserves, provisions and reserve funds which are to be considered as taxable reserves;
- The cost of services which, within the framework of the allowed activities of the distribution centre, are rendered to the centre by third parties, on the condition that these services are invoiced by the third party at a normal price, and thus to include a normal profit margin.

The Belgian central tax authorities grant the treatment provided under the special regime once they have approved the application filed with them. The tax benefits for qualifying Belgian distribution centres are granted for a period of five years and this five-year period can be extended.

C. Service Centres

1. Conditions Attached

According to a circular of 26 July 1996 of the Tax Administration\textsuperscript{xx}, eligible entities are Belgian resident companies, which form part of a group of companies and which:

\begin{enumerate}
\item provide activities of a preparatory or auxiliary nature;
\item provide provision of information to customers;
\item contribute in a passive way to sales operations, and
\item undertake activities of an intermediary with respect to the sale of goods and services by the group.
\end{enumerate}

Service centres may only take a limited enterprise risk with respect to these operations.

2. Tax Benefits

The tax base of a service centre is generally determined according to the normal corporate income tax rules (chargeable at 40,17\%). However, it will be accepted that centres acting on behalf and in the name of the companies of the group have charged to affiliated companies for the services rendered at arm’s length in so far as the total turnover of the centre is no lower than, either:
a) certain operating costs not contributing in an active way to sales plus a minimum profit, depending on the range of activities actually carried out by the centre (cost-plus method); or

b) the profit margin of the centre related to the activities implying an active intervention in sales operations, determined upon the nature of the intervention and the risk taken by the centre (resale minus method).

Belgium has disagreed with the conclusions of the Primarolo report with respect to service centres$^{xxi}$. The report pointed out to the reduced tax base and the fixed determination of the margin taken into account in the cost-plus method.

D. Foreign Sales Companies Ruling

US Corporations carrying on sales operations in certain countries other than the US (e.g. Belgium) may attribute part of the income realised from the sales abroad to the relevant Foreign Sales Company (FSC). Under certain conditions and limitations, the profits thus attributed to the FSC (as taxable abroad) may be exempted in the US.

1. Conditions Attached

A US based enterprise establishing a FSC in Belgium may lodge an application with the Belgian central tax authorities for a ruling under which the taxable income is calculated on the basis of a percentage of certain expenses. The applicant must disclose detailed information about itself and the anticipated FSC (e.g. their legal form, activities, nature of the goods sold through the FSC and costs incurred by it).

The FSC may operate in the form of a Belgian company (subsidiary) or a branch office (permanent establishment) of the US base company.

The ruling, granted on individual basis, is valid for a period of three years and it is tacitly renewed unless either party gives a notice of termination six months before the end of the three-year period. The US based company must, however, in order to keep the ruling valid, annually produce evidence of the US authorities' recognition of the FSC.

2. Tax Benefits

Should the FSC operate in the form of a branch office (Belgian permanent establishment of the US based company), the taxable profit in Belgium is determined on a notional cost
plus basis with a mark-up percentage of 8 %. All "direct" costs incurred by the FSC with respect to advertising and sales promotion activities, transport of goods and assumption of credit risks, may however, be excluded from this notional cost plus tax base. Similarly, the income taxes paid by the FSC are not included in the notional tax base.

In the case where the FSC operates in the form of a subsidiary (a Belgian company) the taxable profit of the FSC is, in principle, determined on the basis of the accounting profit with the necessary tax adjustments. Accordingly, the taxable profit consists of the retained profits, non-deductible expenses and the paid dividends. It is, however, accepted that the FSC’s transactions with affiliated companies are at arm's length (the FSC has not granted any abnormal or benevolent advantages) when the thus determined profits are at least 8 % of the relevant costs incurred by it (see above).

E. Informal Capital Ruling

The concept of informal capital is related to the centralisation (or concentration of a wide range of corporate functions of a (international) group of companies. The scope of the centralised functions that a group company may assume and carry out on behalf of the group is wide and may include, for example, the following types of tasks ;

- commercial strategy development, brand image development, advertising, product development, research activities, distribution strategy planning, co-ordination of vertical management, procurement of raw materials, etc.

According to a decision of the Government of 19 June 1998, setting up an integrated structure for such separate functions may require "an informal capital injection", i.e. group companies place non-material resources (e.g. know-how) which exist at the group level at the disposal of the group company that assumes the responsibility for certain centralised functions xxii.

1. Conditions Attached

All companies taxable in Belgium may apply for the ruling. However, the nature of the activities prevents co-ordination centres, distribution centres and service centres from benefiting from the measure.

2. Tax Benefits
Under Article 24 of the Belgian Income Tax Act (Code des Impôts sur les revenus) only those profits which result from a company’s own activities are taxable in Belgium. Under the ruling, for the first ten years the part of the profits which relates to informal capital (directly contributing to the generation of income) is not considered as resulting from the company’s own activities, but is supposed to correspond to a return on the informal capital.

The informal capital is determined, on a case by case basis and according to the range of activities undertaken, by reference to the net profit margin of the company. This profit margin consists of two elements: the part which is deemed to refer to the company’s own activities (always at least 10 % of the turnover) and that referring to the informal capital. The informal capital amounts to the sum of the annual profit margin referring to the informal capital during a period of 10 years maximum.

The informal capital is amortised for tax purposes over a period of at least 10 years. The injection of the informal capital is not taxable and there is no tax on the informal capital as such but capital gains arising from a subsequent transfer of informal capital and liquidation proceeds are taxable in Belgium.

III. CONCLUSION

All harmful tax measures identified in the report of the Code of Conduct Group should be abolished by January 1, 2003 at the latest. The EU Member States have also “committed” themselves not to introduce new tax measures which would have a harmful effect within the meaning of the Code of Conduct.

Since the Code of Conduct is a political commitment, Belgium, if it wants to respect the principles underlying the Code, will have to remove the harmful measures within the prescribed time frame.


Treaty of Rome, art. 93.

Notice, nr. 26.

Id., nr. 30.


1996.


See, for example, in Germany, Amman, R., Dienstleistungen im internationalen Steuerrecht, Munich, Beck, 1998, p. 237.


Primarolo report, note 17.