Belgium | 28 July 2015

Newsflash
The year of the Cayman

The long awaited look-through tax, also referred to as the 'Cayman tax', has finally been adopted by the Belgian Federal Parliament on 24 July 2015. After the Program Law is published in the Belgian Official Journal, it will apply on income received, attributed or made payable by legal arrangements as of 1 January 2015.

The previous government already introduced an obligation for founders, beneficiaries and potential beneficiaries of 'legal arrangements' to report the existence of the legal arrangement in their annual tax return. This reporting obligation is now complemented by the Cayman Tax.

The Cayman Tax is essentially a look-through tax applicable to Belgian Personal Income Tax ("PIT") and Belgian Legal Entities Tax ("LET") by which income earned by a qualifying legal arrangement is attributed to the founder of such an arrangement as if the latter had received this income directly, and is taxed accordingly in his hands.

The Cayman Tax does not prohibit legal arrangements but aims at further discouraging their use by neutralising their possible tax benefits.

Modifications to the existing reporting obligation

The Program Law does not only introduce a new taxation regime for legal arrangements. It also amends the aforementioned reporting obligation of the founders, beneficiaries and potential beneficiaries of a legal arrangement.

First of all, as of tax year 2016, the reporting obligation also applies to legal entities subject to LET in Belgium, if the legal entity acts as founder or third-party beneficiary of a legal arrangement.

Next to this new reporting obligation for legal entities subject to LET in Belgium, the Program Law introduces a new definition of 'third-party beneficiary' as from income year 2015. A third-party beneficiary is any Belgian tax resident individual or Belgian tax resident legal entity (subject to LET) that receives a financial benefit or benefit in kind from a qualifying legal arrangement. Such third-party beneficiary must report the existence of the legal arrangement in his annual tax return, but only if the legal arrangement has distributed an actual benefit to the third-party beneficiary in the given income year.

The latter is a change: for income year 2013 and 2014, not only founders and beneficiaries, but also *potential* beneficiaries (at any given moment) of a foreign legal arrangement were (or are) obliged to report the existence of the legal arrangement. As from income year 2015 *potential* beneficiaries are no longer required to report the existence of a legal arrangement.

Who is subject to the Cayman Tax?

The Cayman Tax applies to Belgian tax resident individuals (subject to PIT) and non-profit legal entities (subject to LET) that are Belgian tax residents.

The Cayman Tax does not apply to companies subject to Belgian Corporate Income Tax or Belgian non-residents.

The Cayman Tax concerns income taxes

The taxation regime introduced by the Cayman Tax only covers income taxes. Unlike the Dutch APV rules (that served as an inspiration for the Cayman Tax), it does not cover inheritance taxes ("IHT") or gift taxes.

In Belgium, IHT and gift taxes are regional competences. The Flemish tax administration VLABEL has recently published a (debatable) position regarding distributions by discretionary

and non-discretionary trusts. Generally speaking, such distributions are regarded as subject to IHT regardless of the discretionary or non-discretionary character of the trust.

Which legal arrangements fall within the scope of the Cayman Tax?

When the reporting obligation was introduced in 2013, two types of legal arrangements were distinguished (the so-called Type 1 and Type 2 arrangements). The new Program Law keeps this main distinction between Type 1 and Type 2 arrangements but redefines Type 2 arrangements. The distinction is important since different Cayman tax rules apply to Type 1 and Type 2 arrangements.

The definition of Type 1 arrangements is rather vague. Largely, Type 1 arrangements include trusts and trust-like arrangements.

A Type 2 arrangement is now defined as any foreign entity with legal personality (e.g. companies or foundations) either not subject to income tax or subject to income tax representing less than 15% of the taxable income as determined in accordance with the rules applicable under Belgian tax law. This new definition of Type 2 arrangements will apply as of income year 2015.

As it is quite difficult in practice to determine whether or not an entity qualifies as a Type 2 arrangement, the new Program Law provides that two lists of Type 2 arrangements will be published by Royal Decree.

The first list will enclose qualifying arrangements established in the European Economic Area (EEA). This list is intended to be limitative, which means that an EEA entity does not constitute a Type 2 legal arrangement, unless it is included in this list. Moreover, inclusion in this list creates an irrefutable legal presumption that the entity concerned is a Type 2 arrangement. For these EEA entities, it will thus not be possible to demonstrate that they are, for a given tax year, subject to an effective tax rate of 15%.

It is expected that the EEA list will include the Liechtenstein Foundation, *Anstalt* and the Luxembourg *Société de Gestion de Patrimoine Familial*. Under the reporting obligation for income years 2013 and 2014, there was some uncertainty about some other EEA entities (like the Dutch *Vrijgestelde Beleggingsinstelling* and *Stichting-Administratiekantoor*). If these are not included in the EEA list, they will undoubtedly be exempt from the Cayman Tax and the aforementioned reporting obligation.

A second Royal Decree will contain a non-exhaustive list with entities outside the EEA that are deemed to be Type 2 arrangements. However, if it can be proven that such a deemed Type 2 arrangement is subject to an effective tax rate of at least 15% for a given year, then the Cayman Tax regime is not applicable for the corresponding tax year. It is expected that this

second list will include the non-EEA entities already included in an earlier Royal Decree introduced in the framework of the reporting obligation.

It is announced that both Royal Decrees (i.e. the EEA and non-EEA list) will be updated regularly.

Which legal arrangements fall outside the scope of the Cayman Tax?

Subject to certain conditions, the following entities are excluded from the definition of a legal arrangement (and are also seemingly exempt from the reporting obligation):

- Public and institutional undertakings for collective investments;
- Pension funds and entities engaged in the management of employee participations;
- Listed companies;
- A foreign entity with a demonstrated genuine economic activity provided that (1) this entity is established in the EEA, or in a country with which Belgium has concluded a Double Taxation Treaty (DTT) or a Tax Information Exchange Agreement (TIEA), or in a country that participates with Belgium in a bilateral or multilateral legal instrument providing for the exchange of information in tax matters, and that (2) a proportionate correlation can be demonstrated between the activities carried out by this entity and the extent to which it physically exists in terms of premises, staff and equipment.

This final exclusion was added to the draft proposal after concerns were expressed by the Belgian Council of State (*Raad van State/Conseil d'Etat*) regarding the EU compatibility of the proposed Cayman Tax. According to the preparatory works and the wording of the Program Law, both Type 1 and Type 2 arrangements can benefit from this exclusion to the extent that professional income is being generated. The exact scope of this exclusion is however still unclear. Moreover it is questionable whether the scope is broad enough to meet a future EU compatibility test.

It is up to the founder or the third-party beneficiary of a legal arrangement to prove that one of the above exemptions applies.

Who is regarded as a taxpayer under the Cayman Tax?

Founders and third-party beneficiaries act as taxpayers under the Cayman Tax.

For Type 1 arrangements, the following persons are considered as founders:

- any individual (acting outside the exercise of his professional activity) or legal entity (subject to LET) who has set up the legal arrangement;
- any individual (acting outside the exercise of his professional activity) or legal entity (subject to LET) who has settled assets and rights in the legal arrangement; or,

- upon decease of the aforementioned individuals, their (in)direct heirs, unless they can demonstrate that they will never obtain any benefit from the legal arrangement.

For Type 2 arrangements, an additional category is added as founder:

- individuals or legal entities (subject to LET) who hold legal rights on the shares or economic rights on the assets and capitals held by the legal arrangement.

As mentioned before, a third-party beneficiary is any individual or legal entity (subject to LET) that receives a financial benefit or benefit in kind from a legal arrangement, at any time or in any way.

According to the preparatory works of the Program Law, an individual or legal entity can qualify as both founder and third-party beneficiary simultaneously.

Fictional attribution of income

The Program Law provides for a 'fictional' attribution of income from assets owned by the qualifying legal arrangement to the founder, based on the notion of fiscal transparency. Income from assets of such legal arrangement will be taxable in the hands of the founder (without conversion), whether the income is actually distributed to the founder or not. As a consequence, the founder may be taxed on income he will never actually receive.

If the income received by the qualifying legal arrangement is distributed in the same year to a third-party beneficiary, the distributed income is taxable in the hands of the latter and is not taxed in the hands of the founder. However, it is up to the founder to demonstrate that the third-party beneficiary is a tax resident either in Belgium, in an EEA Member State or in any other country with which Belgium has concluded a DTT or TIEA, or in a country that participates with Belgium in a bilateral or multilateral legal instrument providing for the exchange of information in tax matters.

The income will be taxed in accordance with the ordinary Belgian tax rules for the given type of income, which means for example that:

- movable income will be taxed at 25%;
- professional income will be taxed at the progressive tax rates (up to 50%, to be increased with communal surcharges);
- capital gains resulting from the normal administration of a private estate remain tax exempt (art. 90,1° and art. 90,9° ITC).

This notion of fiscal transparency would then logically lead to net income taxation, which would be the gross income after deduction of related costs allowing, for example, to also deduct foreign taxes from the Belgian tax base under the Cayman tax or provide a tax credit for taxes paid by the legal arrangement in the country of establishment. These issues are neither addressed in the Program Law nor in the preparatory works.

Distributions upon liquidation or any other (partially) gratuitous transfer of assets

Quite unexpectedly and contrary to the look-through principle, the Program Law confirms that the liquidation of a Type 2 arrangement is not a tax neutral event. Upon liquidation of a Type 2 arrangement, a liquidation dividend (taxable at 25%) is deemed to be distributed, to the extent that the distribution exceeds the amount of assets that were contributed to the Type 2 arrangement and subject to Belgian tax. This rule was probably introduced to avoid reserves accumulated in such a legal arrangement prior to 1 January 2015 from being distributed tax free.

Furthermore, the Program Law provides that a fully or partially gratuitous transfer of assets out of a Type 2 arrangement is deemed to give rise to a liquidation dividend, again, only to the extent that the distribution exceeds the amount of assets that were contributed to the Type 2 arrangement and subject to Belgian tax. The preparatory works of the Program Law also seem to suggest, arguably, that a transfer of company seat could be considered as a liquidation.

These rules do not apply to Type 1 arrangements.

The conversion of a Type 2 arrangement into a Type 1 arrangement in order to escape taxation upon liquidation is not an option. The Program Law provides that any changes to the deed of incorporation aiming at the conversion of a Type 2 arrangement in a Type 1 arrangement in order to escape taxation upon liquidation will be ignored by the Belgian tax administration.

When will the Cayman Tax not be due?

No Cayman Tax will be due if the founder of a qualifying legal arrangement can demonstrate that the income originating from the legal arrangement assets in a given income year was distributed to a third-party beneficiary in the same income year.

Similarly, the heir-founder (not the original founder) of a Type 1 arrangement will not be liable to the Cayman Tax if he can prove that he will never obtain any benefit from the legal arrangement by renouncing all benefits and supplying evidence of this through the relevant body of the legal arrangement. Even though the preparatory works seemed to indicate that this procedure would also be available to heir-founders of Type 2 arrangements, the text of the Program Law does not seem to provide for this possibility.

Every year, both founder and third-party beneficiary of a Type 2 arrangement can prove that the Effective Tax Rate (ETR) of the legal arrangement is at least 15% of the taxable basis calculated in accordance with Belgian tax law. If this can be proven, the Cayman Tax - including taxation upon distribution of a liquidation dividend - and the aforementioned reporting obligation do not apply for the corresponding tax year. Such evidence cannot be delivered in connection with Type 1 entities.

Anti-abuse rules

A new specific anti-abuse rule regarding the look-through tax has been introduced. Based on the new article 344/1 par.1 ITC, tax authorities are entitled to refuse the recognition of a (series of) legal act(s) by Type 2 arrangements. The scope of this new rule is unclear. The preparatory works seem to indicate that the rule only tackles legal acts aiming at the avoidance of the Cayman Tax.

In addition, any changes to the deed of incorporation, as of 9 October 2014, aiming at the conversion of a Type 2 arrangement into a Type 1 arrangement or the conversion of a Type 1 arrangement into a Type 2 arrangement will be ignored by the tax administration.

The preparatory works indicate that the general anti abuse rule (GAAR) of article 344 §1 ITC remains applicable if other rules fail to apply, e.g. in case of complex structures where a legal arrangement owns other legal arrangements. They also indicate that the Cayman Tax (whether or not in combination with the GAAR) allows to look through such structures in any event, which means that if a legal arrangement (e.g. a trust) holds another legal arrangement (e.g. a foreign non taxed company), the income of the underlying arrangement (the company) will be attributed to the founder directly and taxed accordingly.

To assess the impact of the look-through tax on an existing legal arrangement, please contact a member of the Greenille by Laga team (+32 2 738 06 50).

Alain Nijs, Advocaat-vennoot/Avocat associé, E-mail: anijs@laga.be
Mathieu Ex, Advocaat-vennoot/Avocat associé, E-mail: maex@laga.be
Tillo Dumont, Advocaat-counsel/Avocat counsel, E-mail: tidumont@laga.be
Joris Draye, Advocaat /Avocat, E-mail: jdraye@laga.be
Caroline Costermans, Advocaat /Avocat, E-mail: ccostermans@laga.be

Laga
Berkenlaan 8a
1831 Diegem, Belgium