

Belgian law on PE adjustment to the notional interest deduction basis not EU compliant

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In brief

The European Union Court of Justice (ECJ) in the Argenta case (C-350/11) has ruled that the treatment of foreign permanent establishments (PEs) under the Belgian notional interest deduction (NID) computation did not comply with the EU freedom of establishment. The ECJ ruled that reducing the NID basis by the net book value of assets allocated to PEs in treaty countries (i.e., where the income is in principle exempted in Belgium based on a double tax treaty) restricts the freedom of establishment when compared to taxpayers with a Belgian establishment or a PE whose income is not tax exempt since in this case no adjustment is required.

The Court's reasoning is in line with the Advocate General's opinion delivered on September 19, 2012.

In detail

Belgian NID regime

Belgium, through the NID regime, has introduced a generous corporate tax deduction. Under this regime, Belgian corporate income taxpayers are, for tax purposes, allowed to claim a NID reflecting the economic cost of using capital, which equals the cost of long-term, risk-free financing.

In practice, two factors are multiplied to reach the NID: the "NID rate" and the "NID basis".

- The "NID rate" is determined by referencing the average interest rate on 10-year

Belgian government bonds (for tax year 2014, the reference is to the government bonds of July, August and September 2012 and the rate equals 2.742%).

- The "NID basis" equals the company's share capital plus retained earnings on the last year-end date.

In order to avoid abuse of the NID or double exemptions, taxpayers must make certain adjustments to the NID basis.

Court case

One of the required adjustments was the subject of the Argenta case. The Antwerp Court of first instance asked the ECJ to

examine whether the rule whereby the NID basis is reduced by the net book value of assets allocated to PEs in treaty countries (i.e., where the income is in principle exempted in Belgium based on a double tax treaty) aligns with EU law.

The ECJ ruled that this negative adjustment to the NID basis is a restriction of the freedom of establishment. The freedom of establishment can be interpreted as prohibiting an EU Member State from implementing measures that discriminate against nationals of another Member State or amongst its own nationals seeking to establish themselves in a another Member State.

In addition, the European Commission (EC) initiated an infringement procedure on the same issue. In this procedure, which is still pending, the EC questions not only the PE adjustment but also the adjustment linked to real estate located in other Member States of the European Economic Area. Since the issues are similar, we expect the ECJ

to issue a similar ruling on the foreign real estate adjustment to the NID basis.

The takeaway

US MNCs whose Belgian subsidiaries have foreign PEs should assess this decision's impact on both prior and current NID computations.

Companies may then wish to take appropriate action with the Belgian tax authorities as soon as possible.

Belgium might alter the NID regime in order to bring it in line with the EU freedoms of establishment. Such action should help avoid any negative impact on Belgium's budget.

Let's talk

For a deeper discussion, please contact:

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