Belgium revises its thin cap rules

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Belgium has revised its rules surrounding thin capitalization and the debt to equity ratio.

Traditionally, Belgium has had two specific thin capitalization rules, laid down in two debt/equity ratios:

1. **A 1:1 ratio**, for interest on loans granted either by individuals-shareholders or by individuals-companies exercising a function of company director or similar functions within the borrowing company ("tainted" loans), excluding publicly issued bonds and loans granted by Belgian and other EU companies.

   In that scenario, the interest on any excess tainted loans over and above the sum of the taxed reserves at the start of the relevant financial year and the paid-in share capital at the end of such financial year will be re-qualified as non-deductible dividend income. The same re-qualification applies (outside the 1:1 ratio), where and to the extent the interest from tainted loans exceeds the arm's length limit.

2. **A 7:1 ratio**, for interest on loans ("tainted" loans) granted by a lender which is either not subject to income tax or benefits from a taxation regime which is considerably more favorable than the common taxation regime in Belgium, other than publicly issued bonds. To the extent such loans exceed seven times the sum of the taxed reserves at the start of the relevant financial year and the paid-in share capital at the end of such financial year, the interest on the excess portion does not constitute a deductible business expense.

   However, under Belgium’s new budget for 2012, the legislature has amended and reinforced the second debt/equity ratio, as follows:

   A. The ratio dropped from 7:1 to **5:1** (i.e., the tainted loans should not exceed **five** times the sum of the taxed reserves and the paid-in capital).

   B. Besides publicly issued bonds, are also excluded: loans granted by Belgian or EEA credit institutions.

   C. A new category of tainted lenders has been added: a lender (interest recipient) who is a member of the group to which the Belgian borrower belongs, whereby a group includes all affiliated companies, *i.e.* the companies under legal or factual control ("control" being the legal or factual power to exercise a decisive influence on the composition of the majority of the board of directors). In other words, **intra-group loans now also fall under the 5:1 ratio** (even though the group lender is subject to a normal income tax regime).

   D. There are a few exceptions to the intra-group loans, such as for borrowings by leasing and factoring companies and companies involved in PPP projects.
E. There is one further concession regarding intra-group loans: for borrowing companies which specialize in centralized treasury management for the group based on a framework agreement, only the net paid interest regarding the 5:1 excess loans is disallowed. This means that the paid interest should be first reduced by any interest obtained or received from group companies (other than credit institutions, factoring/leasing companies, non-taxed companies, etc.) as a result of sums put at their disposal under such centralized treasury management. Only the excess debit interest paid to group companies is affected by the 5:1 ratio. This concession should benefit the numerous group treasury centers established in Belgium (i.e., the former coordination centers).

Any Belgian group member receiving a loan from, and paying interest to, another group company (other than a credit institution, etc.) will, however, have to observe the 5:1 ratio, even if the loan forms part of a system of centralized treasury management.

The new rules went into effect July 1, 2012.