



 **ERNST & YOUNG**

*Quality In Everything We Do*

# Important Belgian Tax Incentive Notional Interest Deduction

**COLOPHON****Responsible Editor:**

Jan De Decker

c/o Ernst &amp; Young Tax Consultants

Avenue Marcel Thiry 204

1200 Brussels

**Assistant Editor:**

Stephan Janssens

**All communications should  
be addressed to:**

Stephan Janssens

Ernst &amp; Young Tax Consultants

Avenue Marcel Thiry 204

1200 Brussels

Telephone: 32 2 774 93 72

Fax: 32 2 774 90 90

e-mail: [stephan.janssens@be.ey.com](mailto:stephan.janssens@be.ey.com)[www.ey.com/be](http://www.ey.com/be)[www.ey.be/newsonline](http://www.ey.be/newsonline)**PREFACE**

As of January 1, 2006 Belgium grants a new tax incentive to companies (both Belgian and foreign): the interest deduction for risk capital, better known as the notional interest deduction.

The concept of this notional interest deduction was launched in July 2004 by the Finance Minister, Didier Reynders. The central idea behind the incentive is to let companies, which use their own equity for investments, deduct a (fictitious) interest from their tax base. In this way the differences in the tax treatment between risk capital and debt capital will be eliminated.

The law was voted less than a year later (on June 22, 2005) and published in the Belgian Official Gazette shortly afterwards. One of the less popular components of the incentive (the obligation that the amount of the notional interest should be provisioned during three years) was abolished even before the law came into force.

The author of this brochure, Peter Moreau (Senior Manager at Ernst & Young Tax Consultants) wrote an important study concerning this subject at the end of 2005. This study was published by Kluwer (Belastingaftrek voor risicokapitaal - Notionele interestaftrek: een fiscale revolutie, Wolters Kluwer België, 139 p.).

In this brochure (up to date as per January 1, 2007) you will find a summary of the key elements, conditions and modalities of this tax incentive. Note however that the concrete application of the incentive, and especially the determination of the calculation base of the notional interest deduction is not always simple. Even in situations which, at first sight, seem straightforward, many questions do not find a clear answer in the law or the royal decrees. Ernst & Young has built up an important expertise in these matters. Don't hesitate to contact us for any inquiry you might have.

Stephan Janssens  
Knowledge Center Tax & Legal

Knowledge Center

■ Ernst & Young  
Tax Consultants

Avenue Marcel Thiry 204  
1200 Brussels

■ Tel: (02) 774 93 72  
Fax: (02) 774 90 90

*Due to the gradual disappearance of the special tax regime for Belgian coordination centres, Belgium has lost a major part of its force of attraction to foreign investors. The abolition of the 0.5% registration fee on contributions and the “deduction for risk capital” (also known as the notional interest deduction) has to make up for that loss. Moreover, this measure is EU-proof because it is available to all companies.*

## The concept

As of tax year 2007 (i.e. accounting year ending on December 31, 2006 or later), Belgian companies and foreign companies with a Belgian establishment enjoy a fictitious interest deduction calculated on the basis of their risk capital.

The idea behind the implementation of the notional interest deduction is to reduce the tax discrimination between debt financing (whereby the compensation -interest- is in principle tax deductible), and equity financing (whereby the compensation -dividends- is in principle not tax deductible).

## The Rate

The deduction is equal to a certain percentage of the company's risk capital:

The percentage is set every year and is equal to the annual average of the monthly reference indexes of 10-year Government bonds of the one but last year preceding the year after which the tax year is called. The annual fluctuation may in principle not exceed 1 percentage point (both upward and downward). The reference interest rate is maximum 6.5%. For small and medium-sized enterprises (SMEs) the deduction is increased by 0.5%.

The basic rate for tax year 2007 is 3.442%. For tax year 2008, the rate is 3.781%. The increased rate for SMEs is 4.281%.

## What is risk capital?

The percentage is applied to the company's “risk capital”. By “risk capital” the legislator understands the total equity as projected in the non-consolidated annual accounts at the end of the previous taxable period.

A number of items are deducted from this “basic” risk capital to obtain a “corrected” risk capital that will form the basis for the calculation of the deduction.

What are these corrections? The following amounts are deducted:

- the fiscal net value of the own shares, participating interests and shares posted under financial fixed assets and shares of investment companies which can benefit from the dividend exemption regime (RDT-DBI),
- the net equity assigned to permanent establishments or real estate property or rights situated in a country with which Belgium has concluded a double-tax treaty,
- the net book value of material fixed assets which unreasonably exceed the professional needs,
- the book value of some assets held as investments,
- the net book value of real estate property made available to company managers,
- the part of the expressed but unrealised capital gains exempted of taxes and capital subsidies.

The accounting equity, as aforementioned, is considered at the end of the previous taxable period.

Any change to one of the components in the calculation of the corrected risk capital during the taxable period, both upward and downward, is taken into account in the month following such change for the calculation of a weighted average of corrected risk capital. The deduction for risk capital for the taxable period in question is then calculated on the basis of this weighed average.

## Example

A Belgian company has a building in a country with which Belgium has concluded a double-tax treaty. The accounting value of the building is EUR 250,000. For the calculation of the notional interest deduction, you have to deduct this amount from the accounting equity. If the building is sold on 16 May, not EUR 250,000 will be deducted from the basic risk capital for that year, but only  $\text{EUR } 250,000 \times \frac{5}{12} = \text{EUR } 104,167$ .



*The boundary between optimisation and abuse is often vague*

## Income deduction

The notional interest deduction is deducted from the company's taxable income, but the company may not end up in a loss situation as a result thereof. If there is not enough profit, the deduction can be carried forward to the following accounting years for up to a maximum of 7 years.

Note that there are no other obligations or commitments (f.i. an "investment obligation" or an obligation to provision).

## Anti-abuse provisions

The reform also contains a few provisions to avoid that a company's equity is artificially raised.

It concerns more specifically provisions about assets of which the costs unreasonably exceed the professional needs, assets that are rather part of private capital and real estate property that is made available for use to the company manager (natural person), or his spouse (or their children if they can legally use the income of those children).

In this context we should point out that the burden of proof for the exclusion of an asset from the calculation base, lies with the administration.

Besides these provisions there are some anti-abuse provisions. For example, a company cannot apply deduction for risk capital from received abnormal or gratuitous benefits; and a change of control of a company with the maintenance of transferred deduction risk capital is only possible if the change of control can be justified on the basis of financial or economic reasons.

effect of notional interest deduction on the effective tax pressure and to consider optimisation strategies to maximise the notional interest deduction.

Multinational groups with a Belgian Coordination Centre (BCC) should consider maintaining their activity in Belgium, especially when the BCC's main activity relates to treasury.

## *The notional interest deduction offers Belgian and foreign investors a significant tax relief*

In addition, the Finance Minister expects his departments to thoroughly investigate the changes of risk capital realised on the basis of certain transactions aimed at optimising the deduction of risk capital. Therefore, it is advisable to be careful in your attempts to optimise the deduction for risk capital.

*The notional interest deduction undoubtedly offers a series of opportunities to Belgian and foreign companies. This new corporate tax incentive needs to be properly planned and professional tax advice should be sought. Our Tax Advisors are at your disposition to analyze with you the planning opportunities resulting from this tax incentive.*

## Actions and opportunities

It may be interesting for Belgian companies to revise their position in terms of equity and assets, in order to determine the

## Theoretical calculation of the risk capital:

Accounting equity minus:

- Deduction 1: own shares
- Deduction 2: shares booked under the section financial fixed assets
- Deduction 3: shares of investment companies with dividend exemption
- Deduction 4: equity of taxable permanent establishments abroad
- Deduction 5: taxable real estate property abroad
- Deduction 6: tangible fixed assets exceeding professional needs
- Deduction 7: investment goods
- Deduction 8: real estate property leased to company manager
- Deduction 9: expressed but, unrealised capital gains
- Deduction 10: capital subsidies

## Example

In the annual accounts of the Company ABC we find the following data

### Assets

<u>Material Fixed Assets</u>	
Buildings	250.000
Building X in the Netherlands	100.000
Building Y leased to the company manager	50.000
<u>Financial Fixed Assets</u>	
Shares D	50.000
Shares E	20.000
<u>Liquid Resources</u>	
Cash/Bank/...	5.000
<b>TOTAL</b>	<b>475.000</b>

### Liabilities

<u>Capital</u>	
Share capital	175.000
Taxed reserves	125.000
Revaluation surplus value (exempted part)	25.000
<u>Profits carried forward</u>	45.000
<u>Debts</u>	
Debts in relation to acquisition building X	30.000
Other debts	75.000
<b>TOTAL</b>	<b>475.000</b>

The notional interest deduction is calculated as follows:

Accounting equity:	370.000
Depreciations	
- building in the Netherlands	- 70.000
- building leased to company manager	- 50.000
- shares posted under Fin. Fixed Assets	- 70.000
- revaluation surplus value	- 25.000

**Calculation base for notional interest deduction: 155.000**

**Notional Interest Deduction: 3,781 % x 155,000 € = 5,860.55 €**



## Ernst & Young Tax Consultants in Belgium

Antwerp	Tel: +32 3 270 12 00	Fax: +32 3 235 31 45
Bruges	Tel: +32 50 30 31 00	Fax: +32 50 30 31 32
Brussels	Tel: +32 2 774 91 11	Fax: +32 2 774 90 90
Ghent	Tel: +32 9 242 51 11	Fax: +32 9 242 51 51
Hasselt	Tel: +32 11 28 83 83	Fax: +32 11 24 75 55
Liege	Tel: +32 4 273 76 00	Fax: +32 4 273 76 05

In the preparation of this brochure, every effort has been made to offer current, correct and clearly expressed information. However, the information in the text is intended to afford general guidelines only. This publication is distributed with the understanding that Ernst & Young is not responsible for the result of any actions taken on the basis of information in this publication, nor for any errors or omissions contained herein. Ernst & Young is not attempting through this work to render legal, accounting or tax advice. Readers are encouraged to consult with professional advisors for advice concerning specific matters before making any decision.

The information in this publication should be used as a research tool only, and not in lieu of the tax professional's own research with respect to client matters.

ERNST & YOUNG

[www.ey.com/be](http://www.ey.com/be)

© 2007 Ernst & Young.  
All Rights Reserved.  
Ernst & Young is  
a registered trademark.