

Notional Interest Deduction

At the crossroads of finance, tax and accounting, our clients count on us to look out for their best interests. To develop and deliver the most relevant solutions to suit your particular goals, we work together with the finest lawyers and financial experts. With our roots in banking and a large international network, we have the global reach and local knowledge to help you succeed.

Reflecting Belgium's status as a financial centre, Belgian law provides for a unique tax measure to encourage Belgian and foreign investments, known as the "Notional Interest Deduction".

The "Notional Interest Deduction" allows for a tax deduction for the cost of capital and applies to both Belgian companies and Belgian branches of foreign companies. It enables equity funded Belgian companies and branches to significantly reduce their effective tax rate.

A business-friendly tax environment

Aware of the importance of creating a business-friendly financial environment in Belgium, the Belgian legislator has progressively introduced a framework of tax measures that aim at encouraging companies to locate and develop, amongst others, their intra-group financial activities, treasury centres etc, on Belgian territory.

Since the 1980s, Belgium has been a well-known host country of the so-called "coordination centres", currently being phased out on the basis of European-level decisions. The Notional Interest Deduction, originally introduced as a sort of replacement measure for the coordination centre regime, now gives a new stimulus to amongst others finance company type of activities in Belgium, and this on a much broader level. Moreover, it is automatically applicable to all Belgian companies and Belgian branches of foreign companies and, hence, is a nice add-on to the already existing other very favourable provisions of Belgian tax law which comprise:

- ▶ Absence of capital duties and net worth taxes;
- ▶ Absence of Belgian dividend withholding tax on dividend distributions to

qualifying parent companies located in a treaty partner jurisdiction;

- ▶ Absence of interest and royalty withholding tax on payments made to qualifying related companies located in the EU and Switzerland as well as many treaty jurisdictions (RWHT);
- ▶ Absence of interest withholding tax for qualifying finance companies;
- ▶ General deductibility of acquisition debt, without recapture (making Belgium an ideal location for mixed holding companies);
- ▶ Beneficial participation exemption regime (95% dividend received deduction and 100% capital gains tax exemption for qualifying dividends and capital gains);
- ▶ Absence of real "thin capitalisation" rules;
- ▶ Very extensive and further expanding tax treaty network (currently 87 treaties in force);
- ▶ A well-established ruling practice;
- ▶ Etc.

Main features of the Notional Interest Deduction

The Notional Interest Deduction is a deduction from taxable income determined based on the qualifying equity of the Belgian subsidiary or branch. This equity is then multiplied by an interest rate equal to the average of the 10-year Belgian Government Bond (or "OLO") rate over the

previous financial year. For tax assessment year 2009, this rate is fixed at 4.307% (i.e. the average OLO-rate over 2007). Small companies are allowed to apply a rate increased by 0.5%.

The qualifying equity can be defined as follows:

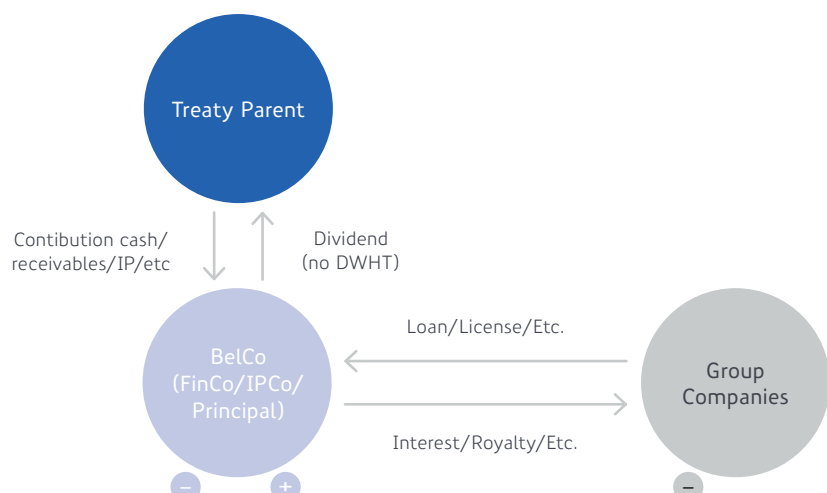
- ▶ Equity: share capital, share premiums, reserves, retained earnings and carried forward profits;
- ▶ Minus: certain adjustments to avoid abuse of the Notional Interest Deduction regime (e.g. own shares; shareholdings; other financial fixed assets; etc.).

In principle and subject to exceptions, the excess Notional Interest Deduction that remains unused for a given year (in case of insufficient taxable income in Belgium) can be carried forward for the next seven years.

Finally, the Notional Interest Deduction has no influence on the accounting figures except of course for tax provisions. This implies that dividends can be distributed even when the fiscal income is zero.

Operational Income, minus:

- ▶ Notional Interest Deduction on equity BelCo;
- ▶ Depreciation on contributed assets (e.g. IP/tangible assets);
- ▶ Possibly tax sparing for royalty WHT levied abroad.






Examples of efficient use of the Notional Interest Deduction regime

The Notional Interest Deduction can provide optimization to the overall effective tax rates for all type of companies such as:

- ▶ Finance companies (intra-group bank; treasury centre): taxation on the spread between the interest-income received and the automatically deductible notional interest deduction on the qualifying equity of the Belgian finance company;
 - ▶ Intellectual property companies or R&D companies: taxation on the spread between the royalty income received on (usufruct on) IP contributed to the Belgian IPCo and the combination of (i) the notional interest deduction on the qualifying equity of the Belgian IPCo including the contributed IP, (ii) the depreciations on the contributed IP and (iii) possibly a domestic tax sparing in case a foreign withholding tax is due ("QFIE/FBB");
- ▶ Principal companies: contribution of profitable assets to a Belgian subsidiary, where the profit located at the level of the Belgian subsidiary would be (partly) offset by the Notional Interest Deduction;
 - ▶ Distribution companies;
 - ▶ Etc.

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