KEY FEATURES OF THE NEW-FANGLED BELGIUM-FRANCE INCOME TAX TREATY

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INTRODUCTION

After nearly two decades of negotiations, Belgium and France signed a new Income Tax Treaty on November 9, 2021 (the "New Treaty"). The New Treaty is in line with the latest O.E.C.D. standards, incorporates the applicable provisions of the Multilateral Instrument (the "M.L.I."), and addresses salient tax issues for taxpayers engaging in cross border transactions involving Belgium and France.

The New Treaty will enter into force when both Belgium and France complete the ratification procedure. In Belgium, the consent of the Federal Parliament and five Regional Parliaments is required. In practice, the New Treaty should not enter into force before January 2023. Until then, the Belgium-France Income Tax Treaty of March 10, 1964 (the "Current Treaty") will remain applicable.

TAXES COVERED

In contrast with the Current Treaty that only applies to income taxes, the New Treaty will cover wealth taxes in addition to income taxes. This larger scope will impact application of (i) the French real estate wealth tax, (ii) the Belgian "Cayman Tax," which imposes Belgian income tax on profits derived through certain low-tax offshore structures, and (iii) the Belgian securities accounts tax, which imposes a tax of 0.15% on securities accounts having an average value in excess of €1.0 million.

RESIDENT STATUS

Under the Current Treaty, a legal entity qualifies as "resident" depending on the location of its effective place of management, without any requirement to be subject-to-tax in Belgium or France. This changes under the New Treaty, which is in line with the latest O.E.C.D. standards. Now, a resident is defined as "any person who, under the laws of [Belgium or France], is liable to tax therein by reason of the person's domicile, residence, place of management or any other criterion of a similar nature." Consequently, a juridical or natural person who is not subject-to-tax in Belgium or France is no longer eligible for Treaty protection.

The new subject-to-tax requirement should exclude most, but not all, investment funds:

- Collective investment undertakings and pension funds may claim benefits under Article 10 (Dividends) and Article 11 (Interest) of the New Treaty even if not "resident" under the standard definition.

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- French translucent entities, such as *sociétés civiles immobilières* ("S.C.I.'s"),[1] will be eligible for Treaty protection provided certain conditions are met. The New Treaty treats partnerships, group of persons, or similar entities as "residents" where the entity (a) has its effective place of management in France, (b) is subject to tax in France, and (c) all of its shareholders, partners, or members are personally subject to tax based on their respective shares in the profits of the entity.

PERMANENT ESTABLISHMENTS

Article 5 of the New Treaty adopts the M.L.I. definition of the term "Permanent Establishment" ("P.E."), thereby enabling French and Belgian tax authorities to challenge artificial arrangements designed to avoid the existence of a P.E. status.

First, the New Treaty broadens the circumstances in which a dependent agent will constitute a P.E. In addition to the existing rule where a dependent agent "acts and habitually concludes contracts on behalf of an enterprise," a P.E. will exist where a person "habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise."

Second, the New Treaty narrows the circumstances in which an agent will be viewed to be an independent agent. Any person who "acts almost exclusively on behalf of one or more enterprises to which that person is closely related" will be deemed not to be an independent agent as to those enterprises. A person is deemed to be "closely related" to an enterprise if one controls the other or both are under the control of the same persons or enterprises. The determination is made based on all the relevant facts and circumstances. Control will typically exist where one of the parties holds a direct or indirect beneficial ownership interest in the other in excess of 50%.

Third, the New Treaty includes an anti-fragmentation rule that applies when determining whether an activity has a "preparatory or auxiliary character" and, for that reason, is not considered to be a P.E. Activity that ordinarily would not constitute a P.E. under Paragraph 4 may be considered to be a P.E. under new Paragraph 4.1 which provides the following limitation:

> Paragraph 4 shall not apply to a fixed place of business that is used or maintained by an enterprise if the same enterprise or a closely related enterprise carries on business activities at the same place or at another place in the same Contracting State and
>
> a. that place or other place constitutes a permanent establishment for the enterprise or the closely related enterprise under the provisions of this Article, or
>
> b. the overall activity resulting from the combination of the activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, is not of a preparatory or auxiliary character,

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[1] S.C.I.'s are corporations that have legal personality under French corporate law, but can elect to be treated as flow-through entities for French corporate tax purposes.

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> provided that the business activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, constitute complementary functions that are part of a cohesive business operation.

In a deviation from the M.L.I., which provides that a building site or a construction and/or installation project must exist for 12 months in order to be treated as a P.E., the New Treaty provides that a P.E. will exist if the site or project exists for nine months. Under the Current Treaty, the period is six months.

REAL ESTATE INCOME

Under the Current Treaty, income derived from immovable property is taxed only in the country where the property is located. This rule is consistent with the traditional O.E.C.D. approach and remains unchanged in the New Treaty.

What is changed by the New Treaty is the treatment of real estate income derived by a Belgian corporation that invests in an S.C.I. or other entity that has legal personality but is treated as tax transparent in France.

"Given the tax transparency of S.C.I.'s, French tax authorities take the position that an S.C.I.'s real estate income should be treated as real estate income derived by shareholders."

Given the tax transparency of S.C.I.'s, French tax authorities take the position that an S.C.I.'s real estate income should be treated as real estate income derived by shareholders. Under this view, the income should be taxable in France under Article 6 (Immovable Property) of the Current Treaty because France is the State where the property is located. In contrast, Belgian tax authorities take the position that, because an S.C.I. has legal personality, income derived by individual shareholders should be characterized as dividends and taxed in Belgium. Not surprisingly, the disparity in views has given rise to tax disputes between the tax authorities of the two States.

The New Treaty addresses the dispute in Article 6 (Immovable Property) and Article 22 (Elimination of Double Taxation). The New Treaty provides that any income distributed by an S.C.I. will be characterized in accordance with Belgian domestic law.

Where the shareholder of an S.C.I. is a Belgian corporation, the income will be taxed in Belgium. The New Treaty allows the Participation Exemption to apply. This is a major development as Belgian tax authorities have argued that the Participation Exemption is not automatically applied.

Generally, corporations with legal personality but that are transparent for corporate tax purposes do not satisfy the qualitative (or subject-to-tax) test. The New Treaty confirms that the subject-to-tax test will not be applied at the level of the S.C.I., provided the Belgian corporate shareholder is taxed in France on the profits of the S.C.I. in proportion to the rights it holds. Other conditions for the Belgian Participation Exemptions remain applicable. In other words, the Belgian corporation must have a minimum shareholding of 10% or a minimum investment of €2.5 million and the shares must be held for an uninterrupted period of at least one year at the time dividends are received. In addition, the Participation Exemption is subject to the condition that the Belgian corporation is taxed in France on the profits of the S.C.I. in proportion to the rights it holds.

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In a nutshell, Belgian corporations receiving dividends from French S.C.I.'s will be eligible for the Belgian Participation Exemption under the New Treaty, without assessing the "subject-to-tax" test at the level of the S.C.I.

DIVIDEND WITHHOLDING TAXES

Article 10 (Dividends) of the Current Treaty limits dividend withholding tax on dividends to a rate of 10% provided the beneficiary is a qualifying parent corporation and meets a minimum ownership percentage or a minimum value for the requisite period of time. If those conditions are not met, the withholding tax is imposed at the rate of 15%.

This will change in the New Treaty. Paragraph 2 of Article 10 of the New Treaty provides a full exemption from dividend withholding tax where the following conditions are met:

- The shareholder holds a direct participation of at least 10% in the share capital of the corporation issuing the dividend throughout a period of 365 days that ends on the day of payment of the dividend.
- The recipient is the beneficial owner of the dividends. Any change of ownership directly resulting from a corporate reorganization of the shareholder or the subsidiary, such as a merger or division, does not affect the calculation of the 365 days holding period.

In all other cases, the New Treaty reduces the dividend withholding taxes to 12.8%, provided the recipient is the beneficial owner of the dividend.

The beneficial owner concept is not defined in Belgian law or in treaties concluded by Belgium. The Commentary to Article 10 of the 2017 O.E.C.D. Model Convention defines a beneficial owner as "the person who has the right to use and enjoy the dividend unconstrained by a contractual or legal obligation to pass on the payment received to another person."

Paragraph 6 of Article 10 of the New Treaty grants withholding tax relief for dividends paid out of income or gains derived from immovable property by an investment vehicle that (a) distributes most of this income annually, and (b) whose income or gains from such immovable property are exempt from tax. The reduction in withholding tax to 12.8% applies if the beneficial owner of the dividends directly or indirectly holds an interest representing less than 10% of the capital of the investment vehicle. Where the beneficial owner of the dividends directly or indirectly holds an interest of 10% or more of the investment vehicle, the dividends may be taxed at the domestic withholding tax rate of the source country.

In the absence of an applicable treaty, dividends paid by a Belgian resident corporation to a nonresident shareholder are subject to a 30% withholding tax. The tax is eliminated if the nonresident shareholder is entitled to the benefits of the Parent-Subsidiary Directive or is resident in a jurisdiction with which Belgium has an income tax treaty in force. Other exemptions and reduced rates are available under Belgian domestic law.

INTEREST WITHHOLDING TAXES

Article 11 (Interest) of the Current Treaty reduces withholding taxes on interest payments to 15%. Article 11 of the New Treaty provides for a full exemption. The exemption applies only when the recipient is the beneficial owner of the interest income.

In the absence of treaty relief, interest paid by a Belgian resident corporation or P.E. to a nonresident lender not entitled to the benefits of the Interest and Royalties Directive ("I.R.D.") is subject to a 30% withholding tax. The tax is eliminated if the I.R.D. is applicable to the interest payment.

Under Belgium's implementation of the I.R.D., and provided certain formalities are fulfilled, interest paid to an E.U. resident corporation is exempt from withholding tax where the recipient is (i) a corporation that holds directly or indirectly at least 25% of the capital of the borrower or (ii) is an associated corporation in relation to the borrower. For these purposes, two corporations are associated if at least 25% of the capital of each of the two corporations is owned directly or indirectly by the same E.U. resident corporation. The formalities are that corporations must have a legal form listed in the annex to the I.R.D. and be subject to corporate income tax.

CAPITAL GAINS TAXATION

Capital Gains on Substantial Holdings by French Individuals

At the present time, Belgium does not have any wealth tax and only exceptionally applies capital gains tax on the sale of shares, which makes it attractive as a place for wealthy investors to reside. For example, the French actor Gérard Depardieu caused a media storm in 2012 after stating that he would move his residence to a small municipality in Belgium, close to the French border, shortly after a so-called "super-tax" on earnings above €1.0 million was introduced in 2012 when François Hollande became President of the French Republic. Even if the French "super-tax" was short-lived as it was repealed in 2015 by François Hollande under public pressure, Belgium became an attractive location for French nationals having sizeable investment portfolios.

For at least two reasons, the attraction of Belgium may come to an end if capital gains tax is the driver for relocation. First, the Belgian Finance Minister has recently announced the intention of the Government to tax capital gain on shares realized by Belgian individuals at a rate of 15%.[2] Second, Paragraphs 2 and 3 of the New Treaty allows France to tax the gains of Belgian residents if the following conditions are met:

- The Belgian resident was previously a French resident for at least six years during the ten-year period preceding the establishment of tax residence in Belgium.
- The capital gain relates to the disposition of shares representing more than 25% of a French corporation.

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[2] For further details about the reform, click here for the French text and here for the Dutch text.

- The tax is imposed only on shares owned on the date the individual establishes Belgian residence.
- The gain is realized within the first seven years after the departure from France.

If an individual who would otherwise be subject to the capital gains tax contributes shares in a French corporation to a Belgian holding corporation, French tax can be imposed on the Belgian holding corporation.

Capital Gains on the Shares of a French Real Estate Corporation

Under the Current Treaty, Belgian residents realizing a capital gain from the sale of shares in a French real estate corporation are exempt from taxation in France and Belgium. The Current Treaty allocates the taxing rights to Belgium, but in most instances, capital gains realized on the shares of a French real estate corporation are exempt from Belgian tax under domestic law.

French tax authorities challenged the double no-tax result, and in 2020, the French Council of State affirmed the position of the tax authorities. The New Treaty adopts the views of the French tax authorities. Paragraph 2 of Article 13 of the New Treaty provides as follows:

> Gains from the alienation of shares or other rights in a company, trust or comparable institution, the assets of which derive more than 50% of their value directly or indirectly from immovable property referred to in Article 6 and situated in a Contracting State, not being property used by such company for the conduct of its business activities, or of rights relating to such property, may be taxed in that State if, under the laws of that State, such gains are subject to the same tax regime as gains from the alienation of immovable property. For the purposes of this provision, no account shall be taken of gains derived from the alienation of shares quoted on a regulated stock exchange in the European Economic Area.

Consequently, when the New Treaty is effective, a Belgian resident individual realizing a capital gain upon the sale of the shares or parts of a French S.C.I. will be subject to a 19% nonresident personal income tax in France and the 7.5% French solidarity tax. If the Belgian resident is a corporation, the 25% French nonresident corporate income tax will be imposed.

FOREIGN TAX CREDIT ON FRENCH-SOURCE DIVIDENDS

Belgian Corporate Shareholders

As previously mentioned, Paragraph 2(c) of Article 22 of the New Treaty confirms that French-source dividends will be exempt from Belgian corporate income tax under the conditions and within the limits provided for in Belgian domestic law.

If the Belgian corporate shareholder is not eligible for the Belgian Participation Exemption, the French tax levied on the dividend income may be claimed as a credit against the Belgian tax liability, which is quite unique in the history of Belgian income tax treaties.

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Belgian Individual Shareholders

In principle, French-source dividends paid to Belgian individuals are subject to a 12.8% dividend withholding tax in France and a 30% income tax in Belgium. To avoid double taxation, the Current Treaty requires Belgium to grant a foreign tax credit equal to at least 15% of the net dividend, after deduction of the French withholding tax. However, in 1988, Belgium abolished the foreign tax credit under its domestic law, subject to certain exceptions. As a result, the Belgian tax authorities refused to allow the foreign tax credit. This position was challenged in court and the Belgian Court of Cassation ruled in favor of taxpayers in three separate cases decided in 2017, 2020 and 2021. Each time, the court explained that international law trumps national law. Consequently, the absence of a national tax rule cannot be used to deny the application of a treaty provision.

After years of litigation, the Belgian tax authorities issued their Circular Letter of May 28, 2021 (the "Circular Letter"), allowing a foreign tax credit on French-source dividends, as mentioned in the Treaty. While Belgian individuals have enthusiastically welcomed the Circular Letter, it will be reversed by reason of Paragraph 2(e) of the New Treaty, which makes the foreign tax credit allowed in the New Treaty to be subject to the provisions of Belgian law, stating as follows:

> Subject to the provisions of Belgian law regarding the deduction from Belgian tax of taxes paid abroad, where a resident of Belgium derives items of his aggregate income for Belgian tax purposes which are interest or royalties, the French tax charged on that income shall be allowed as a credit against Belgian tax relating to such income.

As a result, the total tax burden on Belgian individuals receiving French-source dividends will be increased from 25.88% to 38.96% as indicated in the following table.

NUMERICAL EXAMPLE UNDER THE CURRENT TREATY

Gross Distributed Dividend	€100
– French Dividend W.H.T. of 12.8%	*– €12.8*
Net Dividend Taxable in Belgium	€87.2
– Belgian Dividend W.H.T. of 30%	*– €26.16*
Net Intermediary Dividend	€61.04
+ Belgian Foreign Tax Credit of 15%	*+ €13.08*
Net Dividend	**€74.12**
Total Tax Burden	**25.88%**

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NUMERICAL EXAMPLE UNDER THE NEW TREATY

Item	Amount
Gross Distributed Dividend	€100
– French Dividend W.H.T. of 12.8%	*– €12.8*
Net Dividend Taxable in Belgium	€87.2
– Belgian Dividend W.H.T. of 30%	*– €26.16*
Net Dividend	**€61.04**
Total Tax Burden	**38.96%**

This suggests that Belgian resident individuals may wish to accelerate the distribution of dividends from French companies to a date that is prior to the effective date of the New Treaty, wherever possible.

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