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INSIGHTS

NUPTIAL AGREEMENTS IN THE CONTEXT OF AN INTERNATIONAL COUPLE – VIEWS FROM FRANCE AND SPAIN

NEW BELGIAN FEDERAL GOVERNMENT ANNOUNCES SIGNIFICANT NEW TAX MEASURES

FRENCH BUDGET 2025 – SIGNIFICANT PROVISIONS AFFECTING INDIVIDUALS

AND MORE

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EDITORS' NOTE

In this month's edition of *Insights*, our articles address the following:

- **Prenuptial Agreements in the Context of an International Couple – Views from France and Spain.** Choosing a life partner is a complex decision. It becomes even more complex if the parties are not of the same nationality or if one of the parties moves to another country in order to avoid a two-city lifestyle. Many couples in France and Spain are unaware that, in the absence of a duly executed prenuptial agreement, the rules that determine how property will be distributed if the marriage is dissolved due to divorce or death will be the rules of the first country of residence after their marriage becomes official. Conversely, other couples believe that they are protected by the provisions of a prenuptial agreement signed in France or in Spain that generally provides for separation of property. However, the contract may not be followed in common law countries such as England and United States, meaning that each spouse is entitled to one-half of the marital assets. All this and more are explained in the article authored by Delphine Eskenazi, a Partner of Libra Avocats, Paris, and Maria Valentin, of Counsel to Libra Avocats, Paris. The takeaway is that life can be about more than tax planning.

- **New Belgian Federal Government Announces Significant New Tax Measures.** The most recent general election in Belgium took place in June, but a new government was not sworn in until February, when the five-member coalition government agreed to a federal government agreement, a document of 200 pages in a single language containing many significant tax measures. Tax items addressed include, *inter alia*, (i) the replacement of a dividends received deduction by a simple exclusion, (ii) the modernization of the group contribution regime, the Belgian equivalent of group relief, making it more flexible and simpler to coordinate, (iii) the simplification of the investment deduction rules, the Belgian equivalent of investment credits in the U.S., (iv) the adoption of accelerated depreciation rules for CAPEX investments, (v) the adoption of a "solidarity contribution," a 10% capital gains tax on financial assets held by individuals, allowing a basis step-up to current value as of the effective date of the tax, (vi) simplification of disallowed expense rules, and (vii) the adoption of carried interest rules for managers of investment funds. Werner Heyvaert, a senior international tax lawyer based in Brussels and a partner at AKD Benelux Law Firm explains these and other tax provisions. The takeaway is that Belgium is modernizing its tax rules.

- **French Budget 2025 – Significant Provisions Affecting Individuals.** The French Budget for 2025 reflects significant political instability reflecting two factors. The first is the fragmentation of the French Parliament after elections last summer. The second is a significant budgetary deficit. It was adopted with limited debate on February 14, 2025, after an earlier Finance Bill was rejected in December 2024, resulting in a change of government. Key measures to note include, *inter alia*, (i) Introduction of enhanced social contribution on high incomes, with an instalment that was due in December 2025, (ii) reform of the tax and social security treatment of management packages, including those already in existence, (iii) an overhaul of the tax framework for the B.S.P.C.E., one of the main employee shareholding tools, (iv) tax incentives for gifts received to acquire a new primary residence or to finance energy-efficient renovations, (v) Introduction of a special reassessment period in cases of misreported tax residence, (vi) clarification on the supremacy of treaty law in determining tax residency, (vii) additional social contributions for companies with revenues over a €1 billion, and (vii) a tax on capital reductions linked to share buybacks by companies with revenues exceeding a €1 billion. Philippe

Stebler, the founder of Stebler Avocats, Paris, explains these and other provisions. The takeaway is that, if you thought French taxes in 2024 could not get any higher, you were mistaken.

- **N.H.R. 2.0 in Portugal – a Better Regime for Skilled Workers and Their Employers.** Following the unexpected termination of the N.H.R. regime to newly arrived residents as of December 31, 2023, a new regime was offered, known as N.H.R. 2.0. The new regime attracts working individuals, investors and international groups planning on setting up Portuguese subsidiaries. N.H.R. 2.0 is now fully operational for those within scope of eligible activities, which is very wide. João Luís Araújo, a Partner in the Porto Office of Telles, and Sara Brito Cardoso, an Associate in the Porto Office of Telles, explain why N.H.R. 2.0 provides a better result for newly arrived skilled personnel and their employers. The takeaway is that Portugal is very much open for business and keen to attract talent, companies, and investment.

- **French Tax Investigations target H.N.W. Individuals.** Tax evasion and avoidance have been significant concerns for governments worldwide, and France is no exception. In recent years, the French government has ramped up efforts to investigate high net worth individuals ("H.N.W.I.'s") suspected of tax evasion, particularly as global scrutiny increases over the wealthy's financial practices. France, with its robust tax system and a tradition of enforcing tax compliance, utilizes a range of investigative techniques to target H.N.W.I.'s. The article delves into how French tax investigations are carried out, focusing on methods, legal framework, and high-profile cases involving the wealthy. Sophie Borenstein, a partner of attorneys Klein Wenner, Paris, explains all. The takeaway is that the footprint of an H.N.W.I. is large and is being looked at in detail by French tax authorities.

- **When Baskets Go Beyond Weaving – Understanding Foreign Tax Credit Baskets Under the Look-Through Rules.** While the word "basket" may trigger a mental image of a bicycle with a daisy basket that is a gift in early childhood, the term has a totally different connotation in the tax world. It denotes "foreign tax credit baskets" to an international tax geek in the U.S. The foreign tax credit provisions are among the most complicated areas of U.S. and become further complicated when a "U.S. Shareholder" of a Controlled Foreign Corporation includes income in one year but receives distributions in another. In their article, Neha Rastogi and Stanley C. Ruchelman explore the labyrinth of the foreign tax credit provisions that are designed to ensure that (i) income and (ii) related foreign taxes are reported in the same foreign tax credit basket. The takeaway is that, if the exercise is not computed properly, double taxation of income is sure to arise.

- **New B.O.I. Regulations Under the C.T.A. are Issued by FinCEN.** On Friday, March 21, 2025, the Financial Crimes Enforcement Network ("FinCEN") submitted an interim final rule narrowing the existing beneficial ownership information ("B.O.I.") reporting requirements under the Corporate Transparency Act (the "C.T.A."). Entities previously defined as "domestic reporting companies" now are exempted from the reporting requirements. They do not have to report B.O.I. to FinCEN, or update or correct B.O.I. previously reported to FinCEN. With limited exceptions, the interim final rule does not change the existing filing requirement for foreign reporting companies. As a service to our readers, particularly those based outside the U.S., Insights has published significant excerpts from the preamble of the FinCEN interim regulations, with footnotes deleted. The preamble explains the change in rules, and does so in plain English.

We hope you enjoy this issue.

- The Editors

NUPTIAL AGREEMENTS IN THE CONTEXT OF AN INTERNATIONAL COUPLE – VIEWS FROM FRANCE AND SPAIN

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de Ganay
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INTRODUCTION

Getting married involves choosing the person with whom you want to spend the rest of your life. For most, it is a complex decision. It becomes even more complex if the parties are not of the same nationality or if one of the parties must move to another country in order to avoid a two-city lifestyle.

Many couples in France and Spain are unaware that in the absence of a duly executed prenuptial agreement, the rules that determine how property will be distributed if the marriage is dissolved due to divorce or death will be those of the first country of residence after their marriage becomes official.

This discovery often leads to many disappointments for the less fortunate party in a separation, often the wife who, as a French or Spanish woman married in France or in Spain, lived all her married life with the mistaken belief that she would be protected by French or Spanish rules governing marriage.

Conversely, other couples believe that they are protected by the provisions of a prenuptial agreement signed in France or in Spain that generally provides for separation of property. In that case, the husband is most often the one who discovers at the time of separation that the contract will not necessarily be considered in common law countries such as England, United States, English-speaking Canada, Hong Kong, or Singapore. He then learns that he must share half of his assets with his ex-wife, notwithstanding the fully executed property agreement.

The purpose of this article is therefore to give a few pointers to binational couples, whose lives are intertwined between France or Spain and a common law country such as the United States. Moreover, while France and Spain are neighbors and civil law countries, the applicable rules are actually very different on these issues and could lead to very surprisingly different results.

THE STATUS OF MARRIAGE CONTRACTS AND PRENUPTIAL / POST NUPTIAL AGREEMENTS IN FRANCE

If there is no prenuptial agreement, the spouses will be subject to a matrimonial property regime defined according to certain rules, which are rather complex in an international context.

The concept of matrimonial property regime can be defined as:

> [T]he set of rules concerning property relations between spouses and with respect to third parties, which result from a marriage or its dissolution.

French Law Applicable to Spousal Matrimonial Property Regime in the Absence of a Prenuptial Agreement in France

Historically, one's legal matrimonial property regime is the law implicitly chosen by the spouses. This is often referred to as the law of autonomy. The origin of this rule goes back to an opinion given to the de Ganay spouses in 1525 by Charles Dumoulin, a lawyer who practiced before the Parliament of Paris. He interpreted the legal matrimonial regime as a sort of tacit contract that is subject to the law chosen by the parties. By choosing their domicile, the de Ganay spouses were considered to have expressed their wish to be subject to the customs of their domicile.

This conflict of laws rule based on autonomy of will is still in effect in France for spouses married prior to September 1, 1992. It assumes that, in the absence of a prenuptial agreement and express designation of the applicable law, the judge will investigate the will of the spouses. In this respect, the first marital domicile plays a dominant role. It is the basis of a presumption of an intent to connect the matrimonial regime to the law of the country in which the spouses established their first residence after marriage. This conclusion has been reaffirmed many times in court opinions.

For spouses married after September 1, 1992, the principle is generally that, when there is no prenuptial agreement, the applicable law is the law of the country on whose territory the spouses established their first habitual residence after getting married. This is based on (i) Article 4 of The Hague Convention of 1978 on the Law Applicable to Matrimonial Property Regimes[1] and (ii) Article 26 of the European Matrimonial Property Regimes Regulation ("Article 26"), applicable to spouses married after January 29, 2019.

The application of the national law of the spouses' first "habitual" residence after marriage is thus based on the French system of private international law, which uses the criterion of the first marital domicile as the main indicator of the spouses' implicit intention. But the principle used by the Convention – that the competent law is that of the spouses' first habitual residence – is not open to interpretation. It is the spouses' first habitual residence and there is no need to investigate whether there has been a minimum duration in order to determine the spouses' common habitual residence.

Once the law is determined, the spouses' matrimonial property regime will once again be the legal matrimonial regime of that country. In France, the regime is the community of acquired assets in France.

In addition to the complexity of designating the matrimonial property regime that applies to the spouses after their marriage is the fact that it will sometimes be

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[1] This Convention relates only to property relations between spouses, to the exclusion of spousal support, surviving spouses' right to inherit, and the spouses' capacity. All issues related to personal relations between the spouses are, of course, excluded.

necessary to apply the law of several countries if, for example, the couple then lived for over ten years in a foreign country or if the couple moved to the country of their common nationality. Indeed, the Hague Convention provides for certain situations in which the matrimonial property regime is automatically mutable.[2]

For spouses married after January 29, 2019, and in the absence of a first common habitual residence, Article 26 will apply. In pertinent part, it provides as follows:

> [The law] of (b) the spouses' common nationality at the time of the conclusion of the marriage; or, failing that (c) with which the spouses jointly have the closest connection at the time of the conclusion of the marriage, taking into account all the circumstances [will govern the spouses' matrimonial regime.]

"Finally, one should not forget that, if French law applies, the default matrimonial property regime in France is the regime of community of assets."

Article 26(c) clearly provides unpredictable results as it is commonly difficult to determine the law having the closest connection with the spouses at the conclusion of a marriage when spouses live in different countries. Note that for this purpose, the term "conclusion of the marriage" refers to the time of the marriage.

Finally, one should not forget that, if French law applies, the default matrimonial property regime in France is the regime of community of assets.

Recognition in France of a Foreign Prenuptial Agreement

Now we must raise the question of how prenuptial agreements from English-speaking countries are applied in France, which is not without difficulties when it comes to issues of classification.

Provisions Dealing with the Division of Assets in the Event of Divorce

The main difficulty here is that the concept of a matrimonial property regime does not exist in a strict sense even though common law countries have default rules for the division of spousal property in the absence of a prenuptial agreement. The first question on which a French court must rule when faced with petition to enforce a prenuptial agreement is whether a marital property regime exists in the relevant common law country.

Although the classification is determined under the concept of *lex fori*, French courts generally consider definitions provided in European texts and relevant European

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[2] The Convention of The Hague also provides for certain cases of automatic mutability of the spouses' matrimonial property regime: Nonetheless, if the spouses have neither designated the applicable law nor concluded a marriage contract, the internal law of the State in which they both have their habitual residence shall become applicable, in place of the law previously applicable:

> (1) when that habitual residence is established in that State, if the nationality of that State is their common nationality, or otherwise from the moment they become nationals of that State, or (2) when, after the marriage, that habitual residence has endured for a period of not less than ten years, or (3) when that habitual residence is established, in cases when the matrimonial property regime was subject to the law of the State of the common nationality solely by virtue of sub-paragraph 3 of the second paragraph of Article 4.

jurisprudence. In its *Van den Boogaard* decision,[3] the European Court of Justice clarified that an agreement relates to a support obligation in either of two circumstances. The first is that it provides for an allowance regarding the maintenance of a spouse in need. The second is that the needs and resources of each of the spouses are taken into consideration in determining the amount of the allowance. On the other hand, when an allowance is intended only to divide property between the spouses, the decision relates to a matrimonial property regime (Recitals 21 and 22).

With this guideline in mind, and in the absence of more recent jurisprudence on these issues, it is imperative for spouses to specify in the agreement the obligations that relate to the matrimonial property regime and the obligations that relate to support obligations. A clear distinction in a prenuptial agreement will enable French courts to consider the provisions of the prenuptial agreement when liquidating the spouses' matrimonial property regime.

Provisions Dealing with Spousal Support or Alimony

In English speaking countries, it is common for prenuptial agreements to provide for alimony to be paid in the event of divorce. It is often recommended to the parties to include clauses about financial compensation and spousal support during separation (known as "*prestation compensatoire*" under French law, or "spousal support" or "alimony" in common law countries).

The issue that arises is knowing to what extent such provisions will be applied by French courts ruling on divorce proceedings.

If there is no election to apply foreign law, French law will be applied, making it impossible for a French court to determine the amount to be paid for spousal support or alimony in advance of a final decree of divorce.

The answer is different if there is an election of a foreign law to govern this issue. In principle, an election to apply foreign law would be followed by a French court if the parties (i) elect to apply The Hague Protocol of 2007 on the Law Applicable to Maintenance Obligations, (ii) select a foreign law as the law to be applied to support obligations, and (iii) the selected foreign law allows this type of provision.[4] That is the meaning of the new European text, even though the Court of Cassation has shown a certain reluctance to apply this type of clause in its decisions.

The court will undoubtedly be reluctant when the spouses have provided for a complete waiver of compensatory allowance or other form of spousal support. In fact, the Court of Cassation[5] recently stated that it was incumbent upon the Court to investigate, in a concrete manner, whether the effects of the foreign law designated in the contract were not manifestly contrary to French international public policy.

The question remains open in situations in which the prenuptial agreement provides for sufficient amounts to cover the needs of the spouse seeking spousal support. The question of the validity of such clauses of prenuptial agreements has, therefore, not yet been entirely decided under French law.

3 ECJ, 27 Feb. 1997, case C-220/95, *Van den Boogaard*.

4 Protocol of the Hague on the Law Applicable to Maintenance Obligations, Article 8. This supposes that the substantive and procedural conditions provided by the Protocol for choosing the applicable law have been met.

5 Cass. 1st civ., 8 Jul. 2015, no. 14-17.880.

Recognition in France of a Foreign Prenuptial Agreement

To avoid future complications in an international scenario, a couple should be informed of the option of entering into a French prenuptial agreement ("*contrat de marriage*"). The idea of such contracts is to offer the spouses predictability in the event of divorce by signing a document that can be recognized and applied even if residence outside of France is taken.

The international efficacy of such contracts assumes that they can be recognized in France, in other civil law countries, and in common law countries such as England or the United States.

Recognition assumes that the couple has complied with certain legal requirements that do not exist in French law. To this end, the contract can take the form of a French separation of property contract, provided that certain substantive and procedural rules have been considered so that it is enforceable outside of France.

The question of whether French prenuptial agreements will be recognized is thorniest in common law countries where the rules that apply to prenuptial agreements are very different from the rules that exist under French law. The policy position of American courts is generally to accept the validity of foreign prenuptial agreements, but this validity also assumes compliance with certain requirements in order to increase the chances that a French contract will be recognized and applied in most states in the U.S. Consequently, the following common law concepts should be embodied in the French prenuptial agreement:

- The contract must be just and equitable for both parties ("fairness").
- Each party should receive advice from independent counsel ("independent advice").
- Each party is informed about all elements of the assets of the other party ("full financial disclosure").

Financial disclosure requirements mean that the contract must include a detailed presentation of the assets and income of each party, most often attached as an appendix to the contract. Compliance with these requirements is an important condition for validating a French prenuptial agreement from an Anglo-Saxon perspective.

THE STATUS OF MARRIAGE CONTRACTS AND PRENUPTIAL / POST NUPTIAL AGREEMENTS IN SPAIN

The situation in Spain regarding marriage contracts could be summarized as a hybrid between the French position and the Anglo-Saxon tradition of prenuptial agreements. Traditionally,[6] Spanish law is similar to French law in the sense that the autonomy of will is limited to the matrimonial property regime of the spouses through

[6] Prior to 1975, spouses were not permitted to contract marital rights regarding divorce. Law 14/1975 acknowledged the possibility for women to have legal capacity allowing them to act without the representation of husbands. This law allowed spouses to conclude marriage contracts after the celebration of the marriage.

the concept of the "*capitulaciones matrimoniales*," which translates to "matrimonial capitulations" (referred to below as "marriage contracts").

However, the desire of the spouses to have predictability regarding the consequences of a breakup has led to the use of agreements regulating other aspects of family relations through "*acuerdos en prevision de la rupture*," which translates to "agreements in anticipation of the breakup" (referred to below as "nuptial agreements"). Spanish Courts are predisposed to recognize and enforce foreign prenuptial and postnuptial agreements. Nonetheless, several caveats should be remembered where the parties have connections with Spain, or a possibility exists for review of the agreement by Spanish Courts.

Marriage Contracts Recognized Under Spanish Law Allow for the Divisions of Matrimonial Property

In Spain, it is perfectly possible for parties to have some control over the matrimonial property regime that will apply during the marriage. The validity granted to a prenuptial agreement executed under foreign law that calls for the matrimonial property regime to be governed by that law is recognized under Spanish law.[7] To illustrate, a prenuptial agreement that acknowledges the application of New York State law to property owned by the prospective spouses and specifies the way in which equitable distribution under New York State law generally will be recognized by Spanish courts if the married couple ultimately reside in Spain, albeit perhaps with limited modification.

The Object of Marriage Contracts

Under Spanish national law,[8] couples can choose the matrimonial property regime by means of marriage contracts.[9] Marriage contracts may be entered into before or during the marriage. By definition, marriage contracts choose the matrimonial property regime, meaning the set of rules that govern the property relations between the spouses and with third parties during the marriage. The Spanish Civil Code establishes different matrimonial property regimes,[10] which include the community property regime ("*sociedad de garanciales*"),[11] the participation regime ("*regimen de participación*"),[12] and the separate property regime ("*separación de bienes*").[13]

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7 Terms that would not be incorporated in such covenants are terms not related to the civil law concept of matrimonial property regime. Examples include maintenance, compensation, children's arrangement, personal obligations during the marriage, and use of the family home.

8 The term "Spanish common law" refers to the Spanish Civil Code ("CC") and other laws applicable in the national territory, when autonomous laws do not apply.

9 Articles 1315 and 1326 of the CC.

10 The autonomous laws may contain their own legislation on matrimonial property regimes.

11 Articles 1344 *et seq*. of the CC.

12 Articles 1411 *et seq*. of the CC.

13 Articles 1435 *et seq*. of the CC.

In addition to choosing one of these regimes, the marriage contract can modify or change the matrimonial property regime.[14] The modifications made cannot affect third parties acting in good faith.[15]

The Applicable Regime in the Absence of Marriage Contracts

Under Spanish national law, the applicable property regime is the community property regime.[16] This can be modified by marriage contract, which is important because the matrimonial property regimes vary depending on the connection that each of the spouses has with different parts of Spanish territory.

In the absence of a marriage contract, the domestic territorial law applicable to the matrimonial property regime will need to be determined.[17] In Spain, the determination of the law applicable to the matrimonial property regime is governed by Regulation 2016/1103 establishing enhanced cooperation in the field of jurisdiction, applicable law, recognition, and enforcement of decisions in matters of matrimonial property regimes. If the Regulation is not applicable, the conflict of law rules provided for in Articles 9.2 and 9.3 of the CC apply.[18]

For this purpose, the provisions of Article 9.2 of the CC[19] establishes that the law applicable to the matrimonial property regime is determined by reference to the following criteria:

- First, the common personal law of the spouses at the time of the marriage is applied.[20]
- If that is not determinative, the personal law of the habitual residence of either party may be chosen by both in a public document executed prior to the celebration of the marriage.
- If that is not determinative, the law of the common habitual residence immediately following the marriage is applied or, in the absence of common residence, the place of celebration of the marriage.

14 Article 1325 of the CC.

15 Article 1217 of the CC.

16 Article 1316 of the CC.

17 For examples of the application of Article 9.2 of the CC in the domestic context see Juliana RODRIGUEZ RODRIGO, Aplicación de la norma española de conflicto de leyes interno para determinar el régimen económico matrimonial, Cuadernos de Derecho Transnacional, (October 2023), vol. 15, n°2 pp. 1301-1308.

18 For an example, see Juliana RODRIGUEZ RODRIGO, Ley aplicable al régimen económico matrimonial, a propósito del comentario de la sentencia de la audiencia provincial de Madrid, de 30 Septiembre 2019, Cuadernos de Derecho Transnacional (October 2020), Vol. 12, n°2, pp. 1137-1145.

19 Article 16.3 of the CC establishes that the effects of marriage between Spaniards will be regulated by the Spanish law according to the criteria of article 9 and, in its absence, by the Civil Code.

20 Article 16.1 of the CC establishes that the personal law is determined by "*vecindad civil.*" The *vecindad civil* is a civil status by which a person is considered a resident of a certain territory and determines the personal law applicable in certain matters, among which are the matrimonial regime and the inheritance law.

In the absence of a marriage contract, the application of the foregoing criteria may lead to the application of autonomous legislation when determining the matrimonial property regime. The term autonomous legislation relates to local law that is applicable in 17 autonomous regions, including Andalusia, Catalonia, the Basque Country, Galicia, the Canary Islands, and the Valencian Community. In comparison Spanish national civil law which applies the community property regime, some autonomous laws provide that have adopted the separate property regime as the default regime. Catalonia is an example.

The Validity of the Marriage Contract

When a marriage contract exists and Spanish national law applies, the applicable domestic law for assessing validity of the marriage contract is Article 9.3 of the CC. In turn, the validity of the marriage contract is governed by the general rules applicable to contracts.[21]

In addition, marriage contracts must respect laws, morality, and public order.[22] These precepts include constitutional principles, such as the principle of equality of rights of the parties.[23] Where the foregoing requirements are not wholly met, the marriage contract is not effective.[24]

The Effectiveness of the Marriage Contract

Once a marriage contract is executed, the marriage must be celebrated within one year. If no marriage is celebrated within the one-year period, the marriage contract becomes null and void.[25] With marriage, the economic regime and all marriage contract covenants must be registered in the Civil Registry.[26]

For a marriage contract executed outside of Spain, the scope of the document is limited to the choice of the matrimonial property regime and related provisions. A foreign agreement typically is recognized in Spain once it is assimilated to the traditional figure of a Spanish marriage contract.

It is common for the parties to a marital contract to address matters that go beyond the matrimonial property regime. Where that is done, questions arise as to the validity and enforceability of the terms of the contract in Spain.

Prenuptial and Postnuptial Agreements in the Spanish National Civil Law

Virtually no authoritative guidance exists concerning the legal treatment of Anglo-Saxon prenuptial and postnuptial agreements in Spain. Spanish national civil law provides no definition of prenuptial or post nuptial agreements.

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21 Article 1335 of the CC.

22 Article 1255 of the CC.

23 Article 32 of the Spanish Constitution.

24 Article 1328 of the CC.

25 Article 1334 of the CC.

26 Article 60 of the Civil Registry Law and article 1333 of the CC.

Nonetheless, this type of agreement can be looked at as an agreement to regulate the personal and economic consequences of a possible future marital breakdown.[27] Among private client advisers, these agreements are referred to as agreements in anticipation of a breakup ("nuptial agreements"). Insofar as the Spanish Civil Code does not contain any regulation, the case law of the Spanish Supreme Court provides some guidance in this matter.

The Principle of Validity of Nuptial Agreements

Since the late 1990's, the Spanish Supreme Court has been admitting the validity of such agreements by virtue of the principle of party autonomy.[28]

In a judgment of June 24, 2015, the Supreme Court ruled specifically on the conditions for the validity of a prenuptial agreement.[29] In this case, a married couple executed a marriage contract before a notary designating the matrimonial property regime and, in parallel, concluded a prenuptial agreement a few days before the wedding. In this agreement, they agreed on a monthly rent for life in favor of the wife. That arrangement was not part of the matrimonial property regime.

The Supreme Court considered that this prenuptial agreement fell within the scope of Article 1323 of the Civil Code, which establishes that spouses may transfer property and rights by any title and enter into all kinds of contracts with each other.

To conclude that the prenuptial agreement was valid, the Supreme Court considered the following factors:

- According to the agreement, compliance was not left to the discretion of the spouses, as the conditions that generated the obligation were clear.
- The agreement did not promote the crisis, since neither was in a compromised economic situation.
- The principle of was not violated, since there was no serious prejudice to the husband.
- Neither spouse was in a situation of abuse of a dominant position or in a situation of precariousness.

"Nonetheless, this type of agreement can be looked at as an agreement to regulate the personal and economic consequences of a possible future marital breakdown."

The Spanish Supreme Court concluded that the agreement was valid. It was negotiated by both parties, and the rent was adequate.

In a judgment of May 30, 2018,[30] the Spanish Supreme Court ruled again on the validity of a prenuptial agreement. Prior to the wedding and in the presence of a notary, the individuals waived any possible indemnities or compensatory pensions that might arise in the event of a marital crisis.

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27 Muñoz Navarro, A. J., "*Los pactos prematrimoniales o en previsión de ruptura matrimonial*," *La Ley Derecho de familia: Revista jurídica sobre familia y menores*. Wolter Kluwer, 2020, No. 25, p. 3.

28 STS 325/1997 (RJ 1997/3251); STS 1053/2007 (RJ2007/7307); STS 217/2011 of March 31 (RJ 2011/3137).

29 STS 392/2015

30 STS 315/2018

At some point, the couple encountered difficulties, and the wife filed for divorce. The first instance judge granted a compensatory pension to the wife, considering the agreement null and void for being contrary to the principle of equality. On appeal, the court overturned the decision, ruling that the agreement was valid.

The wife filed an appeal in cassation before the Spanish Supreme Court, which was dismissed. In its decision, the Court referred to factual elements that established informed consent of the parties to the agreement:

- The court considered that the woman was aware of what she signed because she received legal advice from the notary or lawyer.
- The agreement was not contrary to public policy because the woman's employment status, and her limited knowledge of Spanish did not place her in a precarious situation even though she was a Russian national living Spain.
- The principle of equality was not violated because it was a waiver entered into by both parties in the context of a relationship of trust.

It follows from this judgment that, although there are no statutory criteria in Spanish national law, the effectiveness of prenuptial agreements is evidenced by the following factors:

- The parties to the marital agreement each obtained independent legal advice to ensure an understanding of the terms of the agreement.
- The provisions of the marital agreement applied to both parties.
- The terms of the marital agreement were sufficiently clear, so that at the time of their application, neither party was blindsided.

These judgments emphasize that, when dealing with family matters, effectiveness of the agreements will depend on the application of concepts that protect families.

Mandatory Concepts that Apply Nuptial Agreements

As mentioned above for marriage contracts, important limitations exist in nuptial agreements that are based on public policy. When they apply, they may limit the effectiveness of the agreement. For a party to prevail, the nuptial agreement cannot violate concepts of (i) law, (ii) public order, (iii) morality, (iv) constitutional principles such as the equality of spouses in marriage,[31] (v) integral protection of the family and children,[32] (vi) rights and duties of the spouses,[33] (vi) the principle of noncausal separation or divorce,[34] (vii) the rules of the primary matrimonial property regime,[35] (viii) the rules relating to the constitution of the marriage,[36] and (ix) the limits of public order to the paternal-filial relations regarding inability to waive parental authority, custody of the common children, or alimony.

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31 Article 32.1 of the Spanish Constitution.

32 Article 39 of the Spanish Constitution.

33 Article 66 *et seq*. of the CC.

34 Articles 81 and 86 of the CC.

35 Article 1315 of the CC.

36 Article 44 *et seq*. of the CC.

The effectiveness of a prenuptial or a post nuptial agreement will depend on the facts and circumstances presented to a court. Here are several,

- **Agreements affecting minor children.** When a nuptial agreement is related to the use and attribution of the home, validity will depend on whether minor children live at home.[37] If there are minor children, the judge will give priority to the best interests of the child over any nuptial agreement. The best interests of the child will also guide the assessment of the agreements relating to custody and child support.[38] The right to child support cannot be waived.

- **Economic consequences between spouses: maintenance, indemnities, and compensatory pension.** Article 151 of the CC establishes that the right to maintenance is unwaivable. However, the parties may agree on the amounts or forms of payment. A pension or compensation for housework differs from maintenance payments. The agreement should therefore clearly distinguish between the different forms of financial compensation.

- **Provisions concerning the personal relationships between the spouses.** The drafter of the prenuptial agreement or post nuptial agreement must be mindful when including clauses that may deal with personal obligations of the spouses. Clauses that may be interpreted as obliging the spouses to have consensual relationships are not valid.[39] In the same vein, clauses sanctioning infidelity may be closely examined by the Spanish Courts and should be avoided.

"The effectiveness of a prenuptial or a post nuptial agreement will depend on the facts and circumstances presented to a court."

The Form of Nuptial Agreements

In comparison to marriage contracts, the absence of regulations applicable to nuptial agreements means that no standard forms exist. The form to be adopted will depend on the scope of the agreement. For example, if the nuptial agreement falls within the scope of a marriage contract because it relates to the choice of the matrimonial property regime, it must be executed in a public deed. In practice, resorting to a public deed is advisable since it will confer greater probative value to the nuptial agreement and will guarantee that the consent has been freely given.

When a foreign nuptial agreement deals with matters beyond marriage contracts, Spanish law applicable to international private law norms will determine whether it is valid. In other words, nuptial agreements are not regulated by the Spanish Civil Code. Consequently, the validity of the nuptial agreement in Spain will be addressed for the first time upon the breakup of the marriage. Until then, no certainty exists regarding its enforceability until a ruling is issued by a judge. If the parties reside in an autonomous region, surprises may be encountered, as discussed below.

Potential Application of Autonomous Laws

Because the Spanish Civil Code does regulate nuptial agreements, autonomous laws will apply. The law in certain autonomous regions may provide different outcomes as to the enforceability of said agreements. To illustrate, the Catalan Civil

[37] Article 96 of the CC.

[38] Article 1814 of the CC.

[39] Article 10.1 of the Spanish Constitution.

Code (“CCCat”) establishes clear and detailed regulation of nuptial agreements. Among other things, it distinguishes between marriage contracts regulated in Art. 231-19 of the CCCat and agreements regarding a breakup regulated in Art. 231-20 of the CCCat. Regarding the latter, it establishes the conditions to enter said agreements:

- Covenants in anticipation of the breakdown of the marriage may be granted in marital contracts or in a public deed.
- Prenuptial agreements will be valid only if entered during the 30-day period before the celebration of the marriage.
- The notary must inform each of the parties separately about the scope of the changes that are intended to be introduced with respect to the default legal regime. He must also ensure that each party has all necessary information about the default regime and the modified regime.
- Covenants excluding or limiting rights must be reciprocal in nature and clearly specify the rights that are limited or waived.
- The spouse who wishes to rely on a prenuptial agreement rather than the default treatment has the burden of proof as to whether the other party had sufficient information about assets, income, and financial expectations at the time of signing the agreement.
- Covenants that are seriously detrimental to a spouse at the time of enforcement are not effective if circumstances change over time in a way that could not reasonably have been foreseen at the time the parties entered the agreement.

In addition, the Catalan Civil Code establishes substantive conditions for the effectiveness of the nuptial agreement. Here are several examples:

- In anticipation of marital breakdown, the parties may agree on the use of the home by each party.[40] Agreements that harm the interest of the children or that compromise the basic needs of one of the parties are not effective.
- In anticipation of the breakdown of the marriage, the parties can agree on the compensatory pension and the economic compensation for work,[41] including amount, duration, and period of the compensation.

The example of Catalonian law illustrates that, in Spain, the question of recognition and validity of nuptial agreements is complex. Among other things, enforcement may depend on variables such as (i) the choice of law applicable to the substance and form of the agreement and (ii) the geographical location of the Court that rules on the enforcement of the agreement.

[40] Article 233-21 of the CCCat.

[41] Articles 232-7 and 233-16 of the CCCat.

CONCLUSION

When a client has some connection to France or Spain, whether by nationality or residence, and envisions marriage – and possibly divorce – there, assistance of a local attorney having a family law practice is helpful in navigating the uncertain waters of nuptial agreements in France and in Spain. Absent such advice, parties risk an uncertain future regarding the enforcement of a prenuptial agreement or a postnuptial agreement.

NEW BELGIAN FEDERAL GOVERNMENT ANNOUNCES SIGNIFICANT NEW TAX MEASURES

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Tags
Belgium
Capital Gains Tax
Government Agreement
Group Contribution Regime
Investment Deduction Carry-Forward
Participation Exemption
Securities Accounts Tax
Solidarity Contribution

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INTRODUCTION

Following the Belgian general elections of June 9, 2024, five political parties negotiated a new federal government agreement (the "Government Agreement"). The government formation was led by Bart De Wever, president of the largest political party, N-VA, who was sworn in as Prime Minister on February 3, 2025, by King Philip, of Belgium. The new Government Agreement consists of more than 200 pages in one language only and contains many significant tax measures.

This article contains an overview of new tax measures that are relevant for businesses in Belgium, other than employment tax measures. Many of the tax measures discussed below are described only briefly and in general terms in the Government Agreement. Advisers must wait for the publication of draft legislation to determine the potential impact of many of the rules that have been announced. Also, the Government Agreement does not contain a single, clear effective date for the new tax measures. The new government has expressed the ambition to have the bulk of the announced tax measures passed by Parliament before the summer recess, usually starting around Independence Day, July 21.

DIVIDENDS RECEIVED DEDUCTION

Current Rules

The Belgian participation exemption system currently consists of three separate rules:

- The first rule is that all dividends received are initially included in taxable income of the recipient corporation. In a later stage of the corporate tax computation, up to 100% of the qualifying dividends are deducted under the Dividends Received Deduction ("D.R.D.").
- The second rule is that capital gains on the disposal of qualifying shares are fully exempt from corporate income tax.
- The third rule is that the distribution of dividends by a Belgian corporation are exempt from dividend withholding tax, subject to a number of conditions that are similar to the conditions under which dividends received may enjoy the D.R.D.

In order for dividends received to be eligible for the D.R.D., the Belgian corporate shareholder must hold a participation of at least 10% of the shares for an uninterrupted holding period of at least one year. If the Belgian corporate shareholder's participation is less than 10%, the D.R.D. is available if the tax book value of the participation is at least €2.5 million. These minimum thresholds are usually referred to as the "quantitative rule."

As for dividend withholding tax, the current rule is that no withholding tax is imposed when the corporate shareholder holds a participation of at least 10% of the shares. percent. If this is not the case, a Belgian corporate shareholder is allowed to credit the dividend withholding tax against its mainstream corporate income tax liability.

Announced New Rules

It is proposed that the two-step process of inclusion of all dividend income into taxable income followed by a conditional deduction of qualifying dividends will be replaced by a simple exemption for qualifying dividend income, akin to the system that is currently in place for the exemption of capital gains on qualifying shares. This should lead to a substantial simplification, and is also in line with the E.U. Parent & Subsidiary Directive.

The required tax book value under alternative threshold will be increased to €4.0 million. The Government Agreement states that an exception will be provided for small and medium size businesses ("S.M.E.'s").

It is also proposed that an additional condition will be introduced for the application of the D.R.D. The participation must be booked by the corporate shareholder as a financial fixed asset rather than a portfolio investment. This additional test will apply only if the following two conditions are met. First, the participation is worth at least €4 million. Second both the distributing corporation and the corporate shareholder are large enterprises rather than S.M.E.'s.

A third amendment to the D.R.D. regime will apply to a participation in an investment company. A 5% tax will be imposed on the capital gain upon exit. In addition, there the credit for dividend withholding tax disallowed, except when the investor company employs at least one director or manager and the annual compensation paid to at least one of the directors or managers is at least €50,000 annum to at least one of its managers or directors in the taxable period in which the dividend is declared. The €50,000 compensation base will be indexed for inflation.

IMPROVEMENT OF THE GROUP CONTRIBUTION REGIME

Current Rules

Even though Belgium does not have a full-fledged tax consolidation regime, it has a group contribution regime that is similar to the Swedish system. Under the regime, a profitable group corporation is allowed to transfer all or part of its profits to a qualifying group entity, provided that several conditions are met. The losses in the transferee group corporation may be used to offset the profits, provided both are recognized in the same taxable period. The transfer of losses is possible only when there is a direct participation of at least 90% between the transferor and transferee group members.

Under the current group contribution regime, if in any taxable period, a group entity earns dividends which it cannot deduct by virtue of the D.R.D. (see preceding section), the same entity cannot utilize any group contribution received from a related taxpayer to use the D.R.D. in the same taxable period. As a result, the unused D.R.D. will be carried forward to future taxable periods, thereby reducing its net present value, due not only to the timing difference, but also stricter rules that often apply when unused tax attributes are carried forward.

Announced New Rules

Without going into detail, the Government Agreement announces that four changes will be made to the current group contribution regime:

- The regime will be made more flexible and simpler to administer.
- As of the effective date, indirect participations will be taken into account when determining which group members can be transferors and transferees.
- New corporations will no longer be excluded from the group contribution regime. It remains unknown whether only newly incorporated corporations will be allowed to enter an existing group or whether newly acquired corporations will be able to participate.
- Income stemming from a group contribution will no longer be excluded from compensation with any unused D.R.D. in the hands of the recipient corporation.

INVESTMENT DEDUCTION CARRYFORWARD

Current Rule

When a Belgian corporate taxpayer makes certain investments, it can deduct a specified percentage of the investment from its taxable income for the taxable period in which the investment is made (the "Investment Deduction"). If the Belgian investor does not have sufficient taxable income for this period, the unused Investment Deduction can sometimes be carried forward provided that strict conditions are met.

Announced New Rule

The Government Agreement announces that the strict conditions for the transfer of any unused Investment Deduction to future taxable periods will be eliminated.

IMPROVEMENT OF DEPRECIATION RULES

Current Rule

Under current rules, depreciation of capital expenditures ("CAPEX investments") are computed under the straight-line method over a specified number of months.

Announced New Rule

The Government Agreement announces that corporate taxpayers will be allowed to use an accelerated depreciation schemes method, thereby front-loading the amount depreciable. This provision is intended to incentivize CAPEX investments by corporate taxpayers. For large enterprises, depreciation of up to 40% of the investment value is allowed; for S.M.E.s double declining depreciation is allowed.

SECURITIES ACCOUNTS TAX

Current Rule

Since February 2021, an indirect tax of 0.15% per annum is due on any securities account held by a Belgian taxpayer, whether an individual, corporation, or non-public legal entity or body. The tax base is the average weighed value of the securities account.

Announced New Rule

The tax on securities accounts will stay at 0.15% per annum, but certain loopholes will be eliminated. Until a few days before the final Government Agreement was reached, rumors existed that the rate would be increased to 0.25% per annum).

CAPITAL GAINS TAX ON FINANCIAL ASSETS

Current Rule

Subject to certain rarely applied exceptions, capital gains on financial investments, such as shares of stock, remain untaxed in the hands of private individual taxpayers.

Announced New Rule

Private individual investors will be subject to a capital gains tax on financial assets, defined to include, *inter alia*, shares of stock, bonds and crypto assets. The tax is referred to as a "Solidarity Contribution." It will be imposed at the rate of 10% of the realized capital gain. For this purpose, assets will be rebased to eliminate existing unrealized gains. A *de minimis* amount of 10,000 euros will be exempt from the Solidarity Contribution.

At the time of writing, several uncertainties exist, including (i) whether certain life insurance contracts or physical gold will be earmarked as financial assets and (ii) whether existing, but rarely applied, capital gains taxes will be retained. The following scenario illustrates the latter issue.

> A private individual shareholder sells a substantial shareholding to a third party and is subject to the new 10% Solidarity Contribution on the realized gain. On audit, the tax inspector takes the view that the sale of the substantial shareholding was a transaction "outside the scope of the seller's normal management of his personal assets." A 33% personal income tax is imposed on the same capital gain as it constitutes "miscellaneous income." (Section 90, first limb, 9º, dash 1, Income Tax Code.) Open questions include:
>
> 1. Can both types of capital gains tax apply to the same transaction?
> 2. If so, is the Solidarity Contribution a deductible item that reduces the base against which the 33% miscellaneous income tax is applied?
> 3. Alternatively, may the Solidarity Contribution constitute a credit that can be applied against the 33% miscellaneous income tax?

Another private individual shareholder holds more than 25% of the equity of a Belgian corporation. The shares are sold to a corporate buyer established outside the European Economic Area. Apart from the Solidarity Contribution, the seller will, under current rules, be subject to 16.5% capital gains tax. (Section 90, first limb, 9º, dash 2, Income Tax Code.) Open questions include:

1. Will this tax be repealed?
2. If not, is the Solidarity Contribution a deductible item that reduces the base against which the 16.5% capital gains tax is applied?
3. Alternatively, may the Solidarity Contribution constitute a credit that can be applied against the 16.5% capital gains tax?

Based on the text of the Government Agreement, no distinction will be made for purposes of the Solidarity Contribution between shares of Belgian and non-Belgian corporations. However, it can be expected that the Belgian Revenue Service will not systematically be informed of any sales of shares of foreign corporations by Belgian residents, notwithstanding the existing network of international agreements on the automatic exchange of information.

Capital losses will be deductible but only against capital gains realized during the same taxable period. If the taxpayer ends the taxable period with an overall capital loss, the loss will not be carried back or forward to other taxable periods.

Specifically for individual shareholders holding a substantial participation, a staggered rate of Solidarity Contribution will apply.

A substantial participation means a participation of 20 percent or greater. If the shareholder realizes a capital gain on shares pertaining to a substantial participation, the rates are as follows:

Tranche of Capital Gain (€)	Rate of Solidarity Tax
0 - 1,000,000	Exempt (0%)
1,000,001 - 2,500,000	1.25%
2,500,001 - 5,000,000	2.25%
5,000,001 - 10,000,000	5.00%
> 10,000,000	10.00%

It is unclear whether shareholdings of family members will be aggregated to determine whether the selling shareholder has a substantial participation.

The Solidarity Contribution will impact the pricing of acquisitions of Belgian companies held by private individual shareholders. Under existing law, by and large such shareholders are not taxed on any capital gain realized upon the sale of their shareholdings. Going forward, those individuals will be subject to the Solidarity

Contribution. Such sellers may take into account the Solidarity Contribution when setting the sales price for their shareholdings.

DISALLOWED EXPENSES

Current Rules

Disallowed expenses are one of three types of "income" that form the tax base for a Belgian corporation. The other two are the increase or decrease of retained earnings ("Reserves") and the distributed profit ("Dividends"). Over the years, the number of various disallowed expenses and the complexity of the rules to determine their amounts have mushroomed, and pose a huge problem for tax return preparers. Sometimes they impact an otherwise legitimate form of tax planning.

Announced New Rules

Without going into detail, the Government Agreement states that the rules on disallowed expenses will be revised and simplified where possible in combination with an optional regime for a simplified reporting mechanism.

CARRIED INTEREST

Current Rules

Belgium does not have a specific tax regime in place for carried interests held by managers of investment funds. Most structures that are in place today make use of a taxable partnership (a "*commanditaire vennootschap*" or a "*société en commandite*") set up by the fund managers in such a way that the partnership enjoys the participation exemption with respect to income and gains from the shares in managed funds. Upon distribution of income and gains by the taxable partnership to the fund managers, 30% dividend withholding tax is due, which is the final tax for the Belgian individual fund managers.

"The Government Agreement announces that the new government will introduce a tailor-made tax regime for carried interests that is intended to be competitive with the carried interest regimes of other European countries."

Announced New Rules

The Government Agreement announces that the new government will introduce a tailor-made tax regime for carried interests that is intended to be competitive with the carried interest regimes of other European countries. The newly-to-be designed regime should respect existing carried interest schemes and will provide for a tax rate not exceeding 30% for carried interest income.

EXIT TAX FOR CORPORATIONS

Current Rules

Under the currently prevailing corporate income tax rules, the emigration of a Belgian corporation constitutes a deemed liquidation, but only with respect to the corporate income tax rules. Assets of the migrating corporation are deemed to be realized at arm's length value and any deemed capital gain is taxed as if it were a realized capital gain. In most instances, deemed capital gains on shares remain untaxed to the extent that the exemption for capital gains applies, as discussed above. However, since no cash or other cash-like items are extracted from the corporation due to its emigration, no dividend withholding tax applies. Also, legal entities other than corporations are not subject to the exit tax.

Announced New Rules

In a draft version of the Government Agreement, it was announced that upon emigration of a Belgian corporation the deemed liquidation regime would be extended to the dividend withholding tax. In principle, 30% dividend withholding tax would be levied on retained earnings as well as on capital gains that were deemed realized at the time of emigration, even though they are not distributed to shareholders.

Nonetheless, this rule is not retained in the final version of the Government Agreement. According to one of the ghostwriters of the Government Agreement, the purpose is to extend the taxation upon emigration to the dividend withholding tax. The topic is quite sensitive, as in most instances the compatibility of such an additional tax with the E.U. Parent & Subsidiary Directive and/or Belgium's bilateral tax treaties must be taken into account.

BENEFICIAL TAX REGIMES FOR REPATRIATING CORPORATE PROFITS TO INDIVIDUAL SHAREHOLDERS

Current Rules

Today, two beneficial tax systems exist for Belgian individual shareholders to take earnings and profits out of their corporation. The default rule is that the distribution of a dividend is subject to 30% dividend withholding tax. As mentioned above, this is the final tax for Belgian individual shareholders. However, subject to several conditions, this tax can be reduced to 13.64% or to 15% depending on the system that is used, either the "V.V.P.R.bis" system or "liquidation reserve" system.

Announced New Rule

The Government Agreement announces that both systems will be harmonized at the 15% rate. Distributions within three years will be excluded from the harmonized regime. They will be subject to the default withholding tax rate of 30%.

CORPORATE TAX RATE FOR S.M.E.'S

Current Rule

Belgian corporations qualifying as S.M.E.'s enjoy several tax benefits, including a reduced headline corporate tax rate of 20 percent instead of 25 percent on the first €100,000 of taxable income. One of the conditions for a corporation to qualify as an S.M.E. is that it must pay at least €45,000 in compensation to at least one of its corporate officers. This threshold is not indexed for inflation.

Announced New Rule

The new Government Agreement provides that the minimum compensation will be raised to €50,000 per annum, which will be indexed for inflation on an annual basis.

SECURING TAX POSITION FOR CORPORATIONS ENGAGED IN R&D ACTIVITIES

Current Rules

In order to enjoy the Investment Deduction with respect to R&D related investments, Belgian corporations and branches of non-Belgian corporations need a certificate issued by the region where they are established, being Flanders, Brussels or Wallonia.

When applying for an exoneration from wage withholding tax of up to 80% on salaries paid to R&D workers, Belgian corporate taxpayers must register with a governmental body called the Belgian Science Policy Office ("Belspo"). Taxpayers can also apply for an exemption from Belspo to secure their eligibility for the wage withholding tax exemption. In recent years, the Belgian Revenue Service often challenged the exemption claimed by many corporate taxpayers engaged in R&D activities, claiming that their registration with Belspo is strictly not compliant with the statutory rules or is flawed due to inaccuracies by Belspo. Many corporate taxpayers have litigated the restated wage withholding tax assessments, finding it to be a painstakingly long and cumbersome procedure.

Announced New Rules

The Government Agreement announces that the regional certificates for the R&D investment deductions will be scrapped and that the interaction between Belspo and the Belgian Revenue Service will be improved.

With respect to all categories of the 80% exemption from wage withholding tax, the Government Agreement confirms that these tax incentives will continue to exist, even though the new government will run spending reviews to assess their effectiveness. Also, the Government Agreement announces that, for ongoing litigation concerning the 80% exemption of wage withholding tax, a more transparent communication with the Belgian Revenue Service will be adopted.

INCENTIVIZING INVESTMENTS IN EQUITY INSTRUMENTS

Current Rules

Under current rules, there are only very limited incentives for individual investors to invest in "risk-taking" capital or equity. Even though dividends stem from income that is taxed at the level of the distributing corporation, the individual income tax rate is the same as for passive interest income, 30% with no underlying tax credit.

Announced New Rules

The Government Agreement announces that a new specific tax regime will be proposed to incentivize the investment by private individuals in equity of Belgian corporations.

In the mid-1980's, a highly successful regime was available. Subject to certain investment obligations, Belgian corporations were exempt from corporate income tax on dividend distributions to the extent that distributions did not exceed 13% or 8% of the earmarked share capital stemming from fresh capital contributions made in covered years1982 or 1983. This exemption was valid for 10 or 5 consecutive years. At the same time, the personal income tax rate for such dividends was limited to the dividend withholding tax which was not the default rule at that time. In addition, families were granted a tax deduction for up to BF40,000 (approximately €1,000) + BF10,000 (approximately €250) per dependent family member of investment in qualifying newly issued shares. Adjusted for inflation, (i) €1,000 in 1982 correspond to approximately €3,000 in 2025, and (ii) €250 in 1982 correspond to approximately €750 in 2025.

No further details are provided in the Government Agreement regarding the new tax incentive that is announced. One question that comes to mind is whether this new incentive will be restricted to equity investments in Belgian corporations. At first glance, it would appear that any such restriction would constitute an infringement of the freedom of establishment or the free movement of capital in the E.U. By the same token, this type of incentive could constitute impermissible state aid under E.U. rules.

PUBLICLY TRADED SHARES

Announced New Rules

Without going into much detail, the Government Agreement announces several measures to improve the tax regime for publicly traded shares, including the removal of certain existing prohibitive rules for I.P.O.'s.

CLIMATE-FRIENDLY INVESTMENTS

Announced New Rules

Without going into much detail, the Government Agreement announces several measures to streamline and improve the tax regime for climate-friendly investments.

NONDEDUCTIBLE EXPENSES

Current Rules

The current rules on nondeductible expenses for corporations are complex and the number of nondeductible expenses has grown substantially over the years. As previously mentioned, nondeductible expenses are one of three categories of income that comprise the tax base of a Belgian corporation. The other two categories are increases in retained earnings and dividend distributions. Nondeductible expenses are primarily a technical tool to tax certain items that do not show up in the taxpayer's financial statements. Over the years, the reporting of nondeductible expenses has become disproportionately complex.

Announced New Rules

As part of an overall attempt to simplify the corporate income tax rules, the Government Agreement announces a simplified but optional system for the reporting of nondeductible expenses of corporations. No further details are known at the time of writing, except that the new government will strive to simplify the rules on nondeductible automobile costs and expenses, which are among the most complex examples of nondeductible expenses.

Among the other simplifications of the corporate income tax return, the Government Agreement announces the scrapping of the tax exemption for (i) social liabilities regarding potential future costs of redundancy of staff), (ii) private personal computers, and (iii) exemptions for capital gains on cars and vehicles.

REDUCED V.A.T. RATES FOR CLIMATE-UNFRIENDLY COSTS AND INVESTMENTS

Announced New Rules

Among the limited indirect tax measures announced in the Government Agreement, is a plan to scrap the reduced V.A.T. rate which typically is 6% instead of the standard rate of 21% for non-climate-friendly costs and investments. Since input-V.A.T. for businesses is by and large deductible against output-V.A.T., these measures will be less relevant for corporate taxpayers. However, the Government Agreement also announces other tax measures to discourage the use of environmentally unfriendly activities, such as the extension of the lump-sum boarding tax for E.U. and non-E.U. flights departing from Belgium and a specific indirect tax on kerosene which is currently zero-rated for V.A.T.-purposes.

INTRODUCTION OF A DIGITAL TAX

Current Rules

Prior to the roll-out of the worldwide minimum tax known as Pillar II, Belgium announced the introduction of a digital tax. Its purpose was to impose corporate tax on digital service providers that have no physical presence and no permanent establishment in the country but generate income from the exploitation of personal data of the users of their digital platforms. When Pillar II was eventually transposed into Belgian law, the plans for the introduction of a digital tax were stalled.

Announced New Rules

The Government Agreement announces that, in addition to Pillar II, Belgium will introduce a digital tax by no later than 2027, with a view to creating a level playing field between Belgium-based and nonresident digital service providers.

Without mentioning it as such, the Government Agreement also seems to confirm that Belgium will align itself with any new O.E.C.D. and E.U. initiatives to harmonize taxation rules. In principle, it is understood that the competitive position of Belgian businesses will be safeguarded at all times.

ENHANCED LEGAL CERTAINTY

Announced New Measures

With a view to strengthening the position of taxpayers in relation to the Belgian Revenue Service, the Government Agreement announces a number of positive measures. Here is a non-exhaustive list:

"With a view to strengthening the position of taxpayers in relation to the Belgian Revenue Service, the Government Agreement announces a number of positive measures."

- Special attention will be given to applications for Advance Tax Rulings relating to projects that have a substantial impact on investment and employment in Belgium.
- Streamlining of the communication between the taxpayer representatives and the different branches of the Belgian Revenue Service, such as corporate income tax, V.A.T., and wage withholding tax.
- The publication by the Belgian Revenue Service of all case law, including court rulings that are in favor of taxpayers.
- Tax audits will follow a standardized reporting system.
- Administrative guidance will be published faster.
- No disadvantageous tax rules will be introduced with retroactive effect; the government will create a committee to rewrite the Income Tax Code with a view to making the current rules simpler and more transparent.
- A new "charter of the taxpayer" will be adopted to improve the position of the taxpayer in relation to the Belgian Revenue Service, including a procedure for complaints about errors and suboptimal performance within the Belgian Revenue Service.
- Horizontal monitoring will be revitalized.
- The role of the Ruling Commission will be maintained, and the internal functioning will be improved.
- The functioning of the Tax Mediation Service will be assessed and tax inspectors handing disputes will be encouraged to call on the Tax Mediation Service in order to settle disputes with taxpayers out of court.
- Measures are announced to reduce the lead time of tax cases in the courts.
- No penalties will be imposed when a taxpayer makes an initial unintentional mistake.
- Under current rules, no tax attributes can be utilized in any taxable period for which a penalty of 10% or greater is imposed for underreporting- or misreporting. According to the Government Agreement, when a penalty of 10% or greater is imposed, the deduction of tax attributes will again be allowed, with the exception of tax losses incurred during the taxable period.

- Efforts will be made to reduce the number of disputes that are submitted to the courts; one such measure is the introduction of binding arbitration in tax matters; according to one of the ghostwriters of the Government Agreement, this would only be possible for disputes with a certain – yet to be determined – amount of disputed taxes at stake.

- The legal status of unlawfully obtained information will be regulated.

- Procedures and due dates will be harmonized for direct tax and V.A.T., whereby a level playing field will be created between the Belgian Revenue Service and the taxpayer.

- The standard term for the Belgian Revenue Service to investigate and adjust tax returns will continue to be to three years, in general, and four years for complex and semi-complex returns. This is down from six years. When there are indications of tax fraud, the standard term for investigation and adjustment will be reduced to seven years, in general, and eight years for semi-complex and complex tax returns. This is down from ten years.

- Lists of tax havens will be established on January 1 of each year and will not be updated during the taxable year. Jurisdictions that are not on the list on January 1 will not become tax havens during the balance of the taxable year.

Several other measures will be taken to ensure proper tax reporting and assessment:

- Accounts containing cryptocurrency will be open for inspection by the Belgian Revenue Service.

- Belgium will endeavor to enter into as many treaties for cross-border exchanges of information as possible, especially with emerging economies.

- Exchanges of information between various divisions of the Belgian Revenue Service be amplified.

- The federal government commits to help the regions of Flanders, Brussels, and Wallonia to fight against share deals for real estate corporations.

- The government commits to transposing the F.A.S.T.E.R. Directive into Belgian national law. The F.A.S.T.E.R. Directive aims to facilitate a speedier reimbursement and recovery of excessive withholding taxes levied at source on intra-E.U. payments of passive income such as interest, dividends and royalties. The directive was adopted by the Council of Ministers of the E.U. on December 10, 2024, and must be transposed into national law of the Member States by December 31, 2028.

CUSTOMS DUTIES

Announced New Measures

Among the new measures announced in the field of customs duties is the possibility of requesting binding information on the applicable tariffs for the importation of goods into the E.U.

TAX ON PUBLIC TRADING OF SECURITIES

Announced New Rule

The tax on public trading of securities will be modernized and simplified in order to eliminate existing issues and to create a level playing field for securities, corporations, and funds. The rules for funds-of-funds will be revamped. Formalities and regulations regarding I.P.O.s will be reduced and simplified.

IMPROVEMENT OF THE PRIVATE P.R.I.V.A.K. FUND ANNOUNCED

Announced New Rule

Shortcomings in the current regulatory regime for Private P.R.I.V.A.K. Funds will be remedied, such as the limited duration of a Private P.R.I.V.A.K., the number of shareholders, and the scope of permitted investments.

Conversely, the deductibility for a private individual investor of any capital loss upon the liquidation of a Private P.R.I.V.A.K. will be scrapped.

"The new government in Belgium has announced ambitious plans to modernize the tax law and the operations of the Belgium Revenue Service."

INVESTMENT IN SHARES OF STOCK FOR INSTITUTIONAL INVESTORS

Announced New Rule

For institutional investors such as insurance companies and pension funds, the limitation on investment in equity instruments will be softened, in order to allow those investors to invest easily in the real economy.

CONCLUSION

The new government in Belgium has announced ambitious plans to modernize the tax law and the operations of the Belgium Revenue Service. To date, details have been limited. As a result, it is difficult to tell which portion of the Government Agreement reflects must-have items and which portion reflects hopes and dreams. According to people close to the legislative process, the aim is to have the initial draft legislative text ready around Easter. The aim is to enact final legislation before the summer recess in mid-July. The people close to the legislative process have also committed to be open to input and comments from stakeholders once the first draft texts are available pursuant to the public consultation process.

FRENCH BUDGET 2025 – SIGNIFICANT PROVISIONS AFFECTING INDIVIDUALS

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Tags
French Finance Act
Management Packages
Misdeclared Tax Residency
Statute of Limitations
Social Contribution

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INTRODUCTION

Th French Budget for 2025 reflects significant political instability caused by two factors. The first is the fragmentation of the French Parliament after elections last summer. The second is a significant budgetary deficit.

The French Finance Act for 2025 was adopted on February 14, 2025, after an earlier Finance Bill was rejected in December 2024, resulting in a change of government. Due to the use of Article 49.3 of the French constitution, parliamentary debates were limited. After an unusually stable period in French tax policy dating back to 2017, important measures were introduced. More are expected in future Budgets.

BUDGET AT A GLANCE

Key measures to note for individuals include the following:

- Introduction of a new contribution on high incomes, with an instalment due in December 2025
- Reform of the tax and social security treatment of management packages, including those already in existence
- Overhaul of the tax framework for the B.S.P.C.E., one of the main employee shareholding tools
- Tax incentives for gifts received to acquire a new primary residence or to finance energy-efficient renovations
- Clarification on the supremacy of treaty law in determining tax residency
- Expansion of the partial exemption from transfer taxes imposed on the transfer of rural property
- Introduction of a special reassessment period in cases of misreported tax residence.

Key measures to note for businesses include the following:

- Additional contribution for companies with revenues over a €1 billion
- Tax on capital reductions linked to share buybacks by companies with revenues exceeding a €1 billion
- Strengthened measures against dividend arbitrage schemes such as “Cum-Cum” transactions

- Adjustments for the implementation of Pillar 2
- Postponement of the abolition of the C.V.A.E., a local business tax
- Increase in the financial transaction tax.

Other notable measures:

- Temporary 0.5% increase in registration duties on real estate acquisitions
- Crypto-asset reforms, including the transposition of DAC-8 and the adoption of new compliance measures
- Clarification of the tax regime for the new *société de libre partenariat spéciale*

The balance of this article focuses on the principal tax reforms affecting individuals and provides insights into foreseeable changes for high net worth individuals in France.

MANAGEMENT PACKAGES/INCENTIVE PLANS

Previous Landscape for Management Packages and Incentive Plans

In France, management packages are typically divided into two main categories.

The first category includes legally framed incentive plans, *i.e.*, the French commercial code and tax code contain dedicated provisions that specify the legal features, procedures, and tax regimes. Three schemes benefit from a dedicated legal and tax regime:

- **Stock Options**. Due to a lack of tax advantages, stock options have rarely been used in recent years.
- **Free Shares**. Typically used by larger or more mature companies once B.S.P.C.E.'s are no longer available, due to certain tax benefits. However, the employer's social security contribution on the acquisition gain has been increased from 20% to 30% under the Social Security Finance Act 2025.
- **B.S.P.C.E.** ***(Bons de Souscription de Parts de Créateurs d'Entreprise).*** These are essentially Founder Warrants. The B.S.P.C.E. regime benefits from the most advantageous tax treatment. However, they are subject to strict conditions. The company must be in existence for less than 15 years, unlisted, or a small cap (<€150m), with minimum equity held by individuals, either directly or through an intermediary. This management package has features that are similar to those of stock options, such as a strike price. A recent court ruling allowed tax deferral on share-for-share transactions involving B.S.P.C.E.-subscribed shares and a management company, an arrangement that was challenged unsuccessfully by French tax authorities.

The second category encompasses all other incentive plans or management packages. They typically include warrants, commonly referred to as B.S.A.'s (*Bons de Souscription d'Actions*), golden shares, and hybrid instruments. These plans are designed to allow managers to recognize capital gains subject to a more favorable tax rate than salary income.

Over the past decade, the French Supreme Administrative Court (*Conseil d'État*) for taxation and the French Supreme Judicial Court (*Cour de cassation*) for social security have progressively established a framework for reclassifying such gains as salaries. A milestone ruling was issued by the *Conseil d'État* on July 13, 2021 (n°428506, n°435452, and n°437498), distinguishing three types of taxable gains:

- **Acquisition Gain.** The difference between the acquisition price and the fair market value is taxed as salary.
- **Exercise Gain (if applicable).** The difference between the fair market value and the exercise gain is taxed as salary.
- **Capital Gain Upon Sale.** Generally taxed under the capital gains regime, unless there is evidence linking the gain to the beneficiary's role as an employee or executive.

Commonly followed practices in drafting management packages remove or adjust conditions designed to limit the connection between employment at the company and the gain recognized in a transaction involving company shares. Nonetheless, uncertainty surrounding taxation and risks of severe penalties have limited the use of these arrangements. This led advisers to call for a clear legal framework for management packages, similar to those that exist in other jurisdictions.

New Legal Framework for Management Packages and Incentive Plans

Effective for transactions occurring on or after February 15, 2025 even for plans already in existence, capital gains realized upon the sale of shares realized by an employee or director of the company issuing the shares are subject to taxation as salaries. The top rate of tax for such salaries is 59%, a substantial increase from the rate of 34% for classical capital gains. This applies to all management packages and incentive plans, whether covered by a dedicated legal and tax framework or not, subject to certain exception.

Under certain conditions and within specific limits, capital gains on the sale of shares can fully or partly remain taxable under the capital gains regime:

- The transferred shares must contain a risk of loss compared to their acquisition or subscription value.
- A holding period of at least two years is required, except for legal incentive plans which usually have their own conditions on holding periods.

The portion eligible for capital gains taxation is limited to the following formula:

> Subscription price ("S.P.") × financial performance multiple (*i.e.* 3 × fair market value of the company / fair market value of the company at the subscription date) minus the S.P.

The fair market value is defined by law as the fair market value of the equity plus shareholder and related-party loans to the company, with adjustments to account for capital operations between the subscription date and the sale date.

Also, management packages could previously be combined with a highly favorable tax wrapper known as the P.E.A. (*Plan d'Épargne en Actions*) or Savings Plan in Shares, provided that strict conditions were met and capped at certain limits.

However, this combination was often challenged by the French tax authorities and became increasingly restricted over time. Now, management packages are explicitly excluded from this tax wrapper.

The new legal framework leaves certain questions unanswered.

- The first fact pattern involves a cashless reorganization of shares received as a result of management packages or incentive plans, typically a transfer of such shares into a Managers Company ("ManCo"). The Finance Act of 2025 overruled a favorable decision in a recent case and made it clear that B.S.P.C.E.'s exercise gain is taxable. Remaining unanswered is whether the tax on capital gain is imposed immediately or is deferred until the ManCo shares are sold.
- The second fact pattern involves gifts of shares received as a result of management packages or incentive plans. Ordinarily, French tax law allows a step-up in cost basis upon a gift resulting from the actual taxation of the gift. Here, the donor would remain taxable upon the disposal of the shares by the donee. What is the tax basis of the donor? Would there be an elimination of double taxation involving capital gain tax and gift tax?
- If the taxpayer relinquishes tax residence in France, will exit tax be imposed on the gain or is the inherent gain free of French exit tax since it now has the character of salary?
- Will the refinancing or repayment of shareholder loans impact the fair market value used for the computation of the gain's portion subject to capital gain tax rather than tax on salary?
- What reporting obligations will apply?

"Beyond considering this new regime in designing future management packages, individuals benefitting from French source management packages or incentive plans should review whether the change in law may impact their existing packages."

Beyond considering this new regime in designing future management packages, individuals benefitting from French source management packages or incentive plans should review whether the change in law may impact their existing packages.

SPECIAL REASSESSMENT PERIOD IN CASES OF MISDECLARED TAX RESIDENCY

Existing French tax law provides tax authorities strong tools to combat international tax evasion, notably extended statutes of limitations and a flexible definition of individuals' tax residency. The French Budget for 2025 enhances those provisions by introducing an extension of the statute of limitations to ten years in cases where an individual falsely claims tax residency abroad. Highlights regarding income tax and other taxes are as follows.

- **Income Tax**. In principle, French tax authorities have three years after the after the close of the relevant tax year to reassess income tax. However, in specific cases such as hidden activities or undeclared foreign financial assets, the period extends to ten years. The new law confirms that this ten-year applies to false claims of tax residence abroad.

- **Registration Duties, Gift Tax, Inheritance Tax and Real Estate Wealth Tax (“*Impôt sur la Fortune Immobilière*” or “I.F.I.”).** French tax authorities can reassess such taxes up to three years or six years after the relevant tax year, depending on the efforts needed to proceed to reassessment. In addition, French tax authorities can reassess unreported foreign assets such as offshore bank accounts, insurance contracts, and trusts for up to ten years. The ten-year period explicitly covers cases of false claims of tax residence abroad.

The reform completes the already existing extension of statutes of limitations. This reinforcement makes detailed analysis of tax residence more critical than ever. It is not unusual for an individual to become a tax resident unknowingly. In comparison to the substantial presence test in the U.S. and comparable rules in the U.K., French domestic law contains no mathematical approach that looks to residence based solely on the number of days on which an individual is present in France. Instead, an individual is considered to be a French tax resident by satisfying any of the following criteria:

- **Home (or Principal Place of Stay in rare cases).** A person is considered a tax resident in France if a primary home (*foyer*) or a principal place of residence exists in France. The primary home refers to the place where the individual habitually resides and family life is centered.

- **Professional Activity.** A person is considered a tax resident in France if a professional activity is conducted in France, whether salaried or non-salaried, unless the activity is shown to be incidental to an activity that is regularly carried on abroad.

- **Center of Economic Interests.** A person is considered a tax resident in France if the center of the person’s economic interests is in France. This includes the location where most of the income is derived, or the place where the main investments are made, or the place where the assets are managed.

These criteria are far from clear and are subject to differing interpretations by taxpayers, tax authorities, and courts. In cases of dual tax residency involving a country that has an income tax treaty in effect with France, the tiebreaker test for residence under the income tax treaty applies, taking precedence over French domestic law. Tiebreaker tests under income tax treaties generally provide the order in which tests are applied, and once an earlier test confirms a conclusion as to sole residence, the matter is settled.

In addition to extended statutes of limitations, significant fiscal and criminal penalties may be imposed when a person makes a misdeclaration of residence. Though mistakes in tax residence are clearly possible, they are no longer tolerated. A thorough review of tax residency status is now essential for individuals with ties to multiple jurisdictions.

On a side note, it is worth noting that French tax authorities access publicly available information on online platforms, including those that require account registration. It reported that they can engage targeted individuals in electronic exchanges, just like undercover agents in movies. Digital footprints are problematic.

MINIMUM TAXATION RATE FOR HIGH NET WORTH INDIVIDUALS

France has developed a strong capacity to multiply the number of taxes that are imposed on individuals, possibly to avoid an overt increase in tax rates. While different taxes may share similar mechanisms, such as application to revenue or benefits, they often have unique characteristics, which allow certain classes of individuals to be taxed, but not other classes of individuals.

The following list illustrates several of the multiple classes of taxes that may apply to individuals' income:

- **Income Tax.** Up to 45% in general, 12.8% flat tax in principle for dividends, interest and capital gain on shares, 19% flat tax on capital gain on real estate
- **C.S.G. (Social Contribution).** Usually 9.2%
- **C.R.D.S (Other Social Contribution).** Usually 0.5%
- ***Prélèvement de Solidarité* (Another Social Contribution).** 7.5% on passive income
- **E.C.H.I. (Exceptional Contribution on High Income).** Up to 4%

The 2025 Finance Act implemented a differential contribution on high income aimed to serve as a minimum tax of 20%. Such 20% minimum tax does not account for the social contributions mentioned in the above list but only income tax and E.C.H.I. The differential contribution has a scope and tax base similar to the E.C.H.I., with a triggering threshold of €250,000 of income for a single person and €500,000 of income for a couple filing jointly. The tax amount corresponds to the difference between 20% of their adjusted annual income and the sum of income tax plus E.C.H.I. applicable to that income. Exceptional income would be considered at one-quarter of its amount, and the same adjustment applies to the related tax. At the time or writing, the definition of exceptional income has not been published

In practice, this minimum taxation seeks to mitigate the favorable tax rate of 30% to 34% (including E.C.H.I.) applied to dividends, interest, and capital gains, which could now reach an effective rate of 37.2%.

The initial installment of the differential contribution is due in December 2025, based on a preliminary computation of income received between January and November and an estimate of December income, along with related income taxes.

The differential contribution was originally intended to last for three years. However, further steps are considered to combat planning strategies such as the use of holding companies to manage income that is eventually received at the personal level. As a result, the reform is limited to 2025, and the current government is considering a broader overhaul for ultra-high net worth individuals starting in 2026, which would shift the tax base from income to wealth. The reform would resemble the policy of O.E.C.D. Pillar 2, the minimum global tax for large businesses. The government initially proposed a 0.5% global tax on wealth, excluding professional assets. However, an alternative bill, supported by the left-wing but not by the government, proposes a 2% global wealth tax that includes professional assets, with a threshold set at €100 million.

CONCLUSION

France has long been eager to combat tax evasion and aggressive tax planning with a comprehensive set of anti-abuse measures, extended reassessment periods, and significant penalties. The 2025 Finance Act exacerbates an already stringent system, where tax increases often appear as the most immediate solution to projected deficits in public finance.

The news is not all bad, however, as France continues to maintain several relatively stable and competitive tax regimes, such as the inpatriate regime for newcomers, which can be combined with the U.S.-France Income Tax Treaty to offer favorable benefits for U.S. citizens arriving in France as senior corporate executives.

N.H.R. 2.0 IN PORTUGAL – A BETTER REGIME FOR SKILLED WORKERS AND THEIR EMPLOYERS

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INTRODUCTION

Through December 2023, Portugal had in place a successful tax regime aimed at individuals considering a relocation to the country. Known as the Non-Habitual Resident ("N.H.R.") regime, it was introduced in 2009 and was up and running by 2012. All told, the N.H.R. regime attracted well over one-hundred thousand highly skilled professionals and high-net worth individuals and had a positive impact on Portugal's economy.

By 2023, however, Portugal experienced an unrelenting boom in the value of residential real estate. As a result, the Government announced the termination of the N.H.R. regime, effective as of the close of the calendar year, with a transition period running to December 2024. Everyone that was in the N.H.R. regime or was in the process of taking actions to move to Portugal to become eligible for the N.H.R. were not impacted by the change of law. They are able to carry on their N.H.R. status until the end of their 10-year period, as if nothing had happened.

INTRODUCING THE N.H.R. 2.0

At the same time as the N.H.R. was terminated, a new regime was adopted to attract qualfied individuals to move to Portugal. Labelled as the "Tax Incentive for Scientific Research and Innovation," it is commonly referred to as "N.H.R. 2.0." N.H.R. 2.0 came into effect on January 1st, 2024. Implementing regulations were published in December 2024, and again in February 2025. Online forms for application are now available and N.H.R. 2.0 is in full force and effect.

<u>Eligibility Criteria</u>

In order to be eligible for the N.H.R. 2.0, a nonresident individual must meet three tests:

- The first is that the applicant must not have been a tax resident of Portugal at any time within the five years preceding the move.
- The second is that the applicant must become a tax resident of Portugal.
- The third is that the applicant must carry on an eligible activity in Portugal for an eligible company.

The regime does not apply to those who benefit or have benefited from other special tax regimes, such as the N.H.R. regime. Once participation in the N.H.R. 2.0 regime is granted, it remains valid for 10 consecutive, non-renewable years. During each year in that period, the individual must (i) maintain Portuguese tax residence and

(ii) carry on an eligible activity. If the activity ceases for any reason, a firm six-month period is allowed to seek an eligible activity.

Benefits

The benefits granted by the regime can be broadly summarized as follows:

- A 20% flat rate on income earned from an eligible activity in Portugal rather than the progressive rates which would generally apply, with no maximum salary cap; and
- general tax exemption on all foreign income, apart from pension income and certain income sourced in blacklisted jurisdictions.

In comparison to the original N.H.R. regime, the new regime grants a much broader exemption for foreign source income. All foreign source income is tax free apart from pensions and certain income sourced in tax havens.

Application Process

The individual must apply to the regime by January 15th of the year following the move. The employer is part of the process. The degree of its involvement ranges from issuing a simple statement to filing supporting documentation to the Portuguese tax authorities and depends on the eligible activity carried out in Portugal.

ELIGIBLE ACTIVITIES

In order to be granted access to the N.H.R. 2.0 regime, an individual must carry out at least one of following activities for the benefit of a qualifying entity:

- Be a member of the board or carry on a qualified employment position for a company carrying on an economic activity in a sector considered relevant for the national economy. The list of sectors considered relevant for the national economy is quite broad and includes, among others, the following sectors: (i) high tech companies, (ii) holding companies, (iii) regulated asset management entities, (iv) service centers and head office companies, (v) almost all types of manufacturing and mineral extraction entities, (vi) engineering and constructions companies, (vii) film production companies, (viii) R&D companies, and (ix) certain companies in the health sector.
- Be member of the board, or be employed, by an entity certified as a start-up.
- Carry on a qualified employment position for the benefit of a company that participates in the Investment Support Tax Regime (“R.F.A.I.”) or for a industrial or service company that (i) operates in certain sectors and (ii) exports at least 50% of its annual turnover.
- Carry out a listed activity, including (i) teaching at a university, (ii) working in certain scientific research entities, (iii) holding a qualified position or be a board member of a social body that qualifies for specified benefits.

While the Portuguese entity must be a qualifying entity, there are no limitations as to the makeup of its ownership. It can be owned by Portuguese residents, by European

based corporations, or by corporations based outside of Europe other than in non-cooperative jurisdictions.

CASE STUDY

Facts

An individual who has never lived in Portugal is planning to relocate to Portugal in 2025. The individual has a bachelor's degree. He will be employed, as a financial advisor, by a Portuguese asset management company that is licensed by the Portuguese regulator.

The individual has not been a resident of Portugal for the period running between 2020 and 2024. In addition, the employer is engaged in an economic activity recognized as relevant to the Portuguese economy. The individual will be taking a qualified job position and has the necessary academic qualifications.

Result

In the above fact pattern, the individual will be eligible for the new N.H.R. 2.0 regime. To obtain benefits, he must apply no later than January 15th, 2026.

Apart from the flat rate of 20% over his Portuguese employment income, the individual will benefit from an exemption on his foreign income provided the foreign income is not pension-related or blacklisted. The benefit of the exemption is not lost merely because funds are remitted to Portugal.

CONCLUSION

Following the unexpected termination of the N.H.R. regime, effective as of the December 31, 2023, a new regime was offered to newly arriving residents, known as N.H.R. 2.0. The new regime attracts working individuals, investors and international groups planning on setting up Portuguese subsidiaries. N.H.R. 2.0 is now fully operational for those within scope of eligible activities, which is very wide. The goal is to attract individuals working for a wide range of entities such as manufacturers, tech companies, management companies, family offices, private or corporate holding structures, and many others.

N.H.R. 2.0 is a clear sign that Portugal is very much open for business and keen to attract talent, companies and investment. With proper thought and planning, the new N.H.R. 2.0 can be even more advantageous than the previous tax regime.

"N.H.R. 2.0 is a clear sign that Portugal is very much open for business and keen to attract talent, companies and investment."

FRENCH TAX INVESTIGATIONS TARGET H.N.W. INDIVIDUALS

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INTRODUCTION

Tax evasion and avoidance have been significant concerns for governments worldwide, and France is no exception. In recent years, the French government has ramped up efforts to investigate high net worth individuals ("H.N.W.I.'s") suspected of tax evasion, particularly as global scrutiny increases over the wealthy's financial practices. France, with its robust tax system and a tradition of enforcing tax compliance, utilizes a range of investigative techniques to target H.N.W.I.'s. This article delves into how French tax investigations are carried out, focusing on methods, legal framework, and high-profile cases involving the wealthy.

THE FRENCH TAX AUTHORITY: A POWERFUL ENTITY

The French tax system is managed by the *Direction Générale des Finances Publiques* ("D.G.F.I.P.'). It is one of the most powerful government bodies in France, responsible for managing all aspects of taxation. In its efforts to combat tax evasion, the D.G.F.I.P. works closely with other national and international entities such as the French National Financial Prosecutor's Office ("P.N.F."), the police, and financial intelligence agencies.

The French government has been particularly proactive in targeting H.N.W.I.'s and ultra-high-net-worth individuals ("U.H.N.W.I.'s") due to expectations of large tax revenue that can potentially be collected from such individuals, who are believed to use complex financial structures, offshore accounts, and other sophisticated tax avoidance schemes.

INVESTIGATIVE METHODS: A COMPREHENSIVE APPROACH

To investigate high-net-worth individuals, French authorities employ several sophisticated techniques and tools. Some of the key methods used in these investigations are described below.

Lifestyle Audits

One of the most common methods used to target H.N.W.I.'s is the lifestyle audit. French authorities scrutinize the apparent discrepancies between an individual's reported income and visible wealth. These audits can involve analyzing the target individual's spending patterns, assets, luxury purchases, and travel habits. Red flags pop up if someone with modest declared income is seen purchasing expensive real estate, or high priced automobiles, or traveling frequently to exclusive destinations.

Tax Evasion and Fraud Investigations

French authorities have specialized units dedicated to investigating complex cases of tax fraud and evasion. These units track down individuals who utilize offshore trusts, shell companies, or other financial tools to hide their wealth from tax authorities. In some cases, this involves cross-border collaboration with international organizations such as the Organisation for Economic Co-operation and Development ("O.E.C.D.") or tax jurisdictions like Luxembourg and the Cayman Islands that serve as financial hubs for offshore accounts.

Data Leaks and Whistleblower Revelations

High profile cases have been exposed through data leaks from whistleblowers or investigative journalists. A notable example is the Panama Papers leak of 2016, which revealed how many of the world's richest individuals and corporations use offshore companies and trusts to evade taxes. Following such leaks, the French tax authorities initiated investigations into several French nationals who were named. Leaked data provides a goldmine of information that tax authorities can use to probe further into potential tax evasions.

Cross-Border Cooperation and International Agreements

Tax authorities in France have benefited from increased international cooperation in recent years, thanks to agreements like the Common Reporting Standard ("C.R.S.") and the Automatic Exchange of Information ("A.E.o.I."). These agreements allow tax authorities to receive details about foreign bank accounts, assets, and income of French citizens and residents. These systems help investigators track down financial activities in offshore jurisdictions, providing the necessary data to conduct thorough audits.

FRENCH LEGAL / REGULATORY FRAMEWORK

France has a well-defined legal framework for investigating and prosecuting tax evasion. Under French law, tax evasion can lead to hefty fines, asset seizures, and in extreme cases, prison sentences. Some key legal provisions include:

The French Tax Code

The French Tax Code is designed to ensure that taxpayers comply with their obligations, and it grants authorities broad powers to investigate and enforce compliance. Provisions under the Code allow the D.G.F.I.P. to inspect private and corporate financial documents, audit businesses, and issue penalties for fraudulent activities.

Criminal Liability for Tax Fraud

Tax fraud in France is considered a criminal offense. Article 1741 of the French Tax Code allows for the imposition of financial and criminal penalties for individuals who are found to have deliberately evaded taxes. Depending on the scale of the fraud, penalties can range from fines to imprisonment. The penalties for major cases of tax evasion can also include asset forfeiture and the dismantling of illicit financial structures.

FRENCH ANTI-MONEY LAUNDERING LAWS

Anti-money laundering ("A.M.L.") legislation in France plays a crucial role in combating tax evasion. The Law Sapin II, passed in 2016, includes provisions for preventing corruption and increasing the transparency of financial dealings. This law obliges financial institutions to report suspicious activities, which helps identify illegal financial flows linked to tax evasion schemes.

HIGH-PROFILE CASES: EXPOSING THE WEALTHY

France has witnessed several high-profile cases in which prominent individuals were investigated or prosecuted for tax evasion. These cases often attract media attention and serve as a warning to others in similar situations.

The Case of Gérard Depardieu

One of the most well-known cases in France was that of the actor Gérard Depardieu, who famously became a tax exile to Russia after disputes over France's high tax rates. Although Depardieu was not directly accused of tax evasion, his move drew attention to the lengths some wealthy individuals would go to avoid high taxes in France. He became a Belgium tax resident in February 2024, and is under investigation in France for tax fraud because of his residence in Belgium.

The Cahuzac Affair

One of the most dramatic cases involved Jérôme Cahuzac, the former French Minister for the Budget, who was found to have hidden significant sums of money in offshore accounts. Cahuzac initially denied the accusations but was later convicted of tax fraud and money laundering. He was finally sentenced to three years' imprisonment and five years' ineligibility.

His case highlighted the significant risks involved in evading taxes at the highest levels of government.

The Bettencourt Affair

The L'Oréal heiress Liliane Bettencourt was involved in 2011 in a major tax evasion case when it was revealed that her wealth, estimated at several billion euros, had been hidden in various offshore accounts. While the Bettencourt family was not directly prosecuted for evasion, the case underscored the intensity of scrutiny that France places on wealthy individuals suspected of financial mismanagement or fraudulent behavior.

The Role of Transparency in Combatting Tax Evasion

As the global community becomes more focused on ensuring that the wealthy pay their fair share of taxes, French authorities are continuously strengthening transparency measures. The Public Country-by-Country Reporting ("C-b-C Reports") requirement, which mandates that multinational corporations must report their profits and tax contributions in each country they operate, is a step towards greater accountability.

In addition, the French government has also supported international initiatives to eliminate tax havens and increase cooperation between tax authorities globally. The European Union's anti-tax avoidance directives ("A.T.A.D.") and the O.E.C.D.'s Base Erosion and Profit Shifting ("B.E.P.S.") framework have further strengthened France's resolve in tackling tax evasion by H.N.W.I.'s.

NEW TAXATION PROVISIONS AND 2025 FINANCE BILL

The 20% Minimum Contribution Requirement

Under the 2025 Finance Bill, a new minimum contribution requirement will be applied to individuals whose income exceeds a certain threshold. This contribution is designed to ensure that high-income earners pay at least 20% in taxes on their total income, after deductions and allowances.

If an individual's total tax rate (including income taxes and social contributions) falls below 20%, a surtax must be paid to increase the total tax liability to the 20% minimum. This measure ensures that even those with complex financial arrangements or significant deductions contribute fairly to the tax system.

Taxation of Management Package Gains

The 2025 Finance Bill also introduces new provisions aimed at more aggressively taxing management package gains.

The management package refers to the equity-based compensation given to executives and high-level employees, often in the form of stock options, performance shares, or bonuses tied to the long-term performance of a company. For many years, management packages have been a way for high-income earners to benefit from lower tax rates compared to regular salary income by classifying the gains as capital gains rather than income.

In recent years, there has been growing concern over the tax inequities associated with these compensation structures. In response, the 2025 Finance Bill introduces a new tax regime specifically designed to increase the tax burden on management packages. The goal is to align the taxation of these packages with ordinary income and curb potential tax avoidance by wealthier individuals.

Under the previous tax regime, gains from management packages were often classified as capital gains if certain conditions were met. Such gains were taxed at favorable rates when compared to regular income. For example, the capital gains tax rate was around 30%, which is significantly lower than the rates for income tax, which top out at 45%.

The 2025 Finance Bill introduces a new tax structure under which management package gains will be treated as ordinary income and will be taxed progressively. Consequently, these gains will be taxed at the same rates as regular salaries. In addition, a 14% social security contribution applied to these packages, resulting in a combined tax rate of 59%. The 59% tax rate for management package gains is among the highest in Europe, marking a stark contrast to the previous regime where management packages were often taxed more lightly. The goal of this policy is twofold:

- **Equalize Taxation.** Ensure that executives and top earners are taxed at the same rates as ordinary employees, thus closing the gap between their income and the tax burden borne by regular workers
- **Discourage Tax Avoidance.** Discourage the use of management packages as a means to avoid higher income tax rates. Previously, many top executives took advantage of these packages to reduce their effective tax rate, sometimes by classifying compensation as capital gains rather than ordinary income

Some exceptions to the 59% tax rate may apply.

- Stock options and performance shares may still benefit from lower rates depending on the length of the holding period and the type of package. Executives may still benefit from a lower tax rate if the package was granted several years prior to being exercised or realized.
- The tax rate on capital gains from company shares may remain lower if the shares are sold after a holding period of more than two years. This aspect is designed to encourage long-term investment in the company they manage. However, such capital gain tax treatment will apply only under certain conditions.

This new management package tax regime reflects increasing calls for wealthy executives and entrepreneurs to contribute more to the tax system, especially U.H.N.W.I.'s who derive much of their income from performance-based equity compensation.

"Consequently, for 2025, the wealth tax remains applicable only to real estate."

Proposal to Expand the Scope of Assets Subject to Wealth Tax

A proposal was put forth for the transformation of the current wealth tax into an unproductive wealth tax. Under the proposal, other assets would be added to the tax base, such as (i) saving accounts (ii) literary, artistic and industrial property rights of which the taxpayer is not the author or inventor, and (iii) cryptocurrencies. To counterbalance the new base, the tax threshold at which a taxpayer becomes liable would have been raised from the current €1.3 million to €2.57 million.

The proposal was abandoned by the Parliament during the final vote of the 2025 Finance Bill). Consequently, for 2025, the wealth tax remains applicable only to real estate.

CONCLUSION

Tax investigations targeting H.N.W.I. individuals in France are becoming increasingly sophisticated as the country employs a combination of data analysis, international cooperation, and lifestyle audits to combat tax evasion. Additionally, the 2025 Finance Bill and recent actions by the French Senate are reshaping the taxation of the wealthy. As transparency increases and international tax regulations continue to evolve, France is positioning itself as a key player in global efforts to enforce tax compliance among its wealthiest citizens, fostering a fairer and more balanced tax system according to proponents of higher taxes.

WHEN BASKETS GO BEYOND WEAVING – UNDERSTANDING FOREIGN TAX CREDIT BASKETS UNDER THE LOOK-THROUGH RULES

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Tags
Controlled Foreign Corporation
Dividend
Foreign Tax Credit
High Tax Kick Out
Look Through Rule
Previously Taxed Income
Subpart F

INTRODUCTION

While the word "basket" may trigger a mental image of a bicycle with a daisy basket that is a gift in early childhood, the term has a totally different connotation in the tax world. It denotes "foreign tax credit baskets" to an international tax geek in the U.S.

The foreign tax credit provisions are among the most complicated areas of the U.S. Internal Revenue Code ("Code"), and become further complicated when a "U.S. Shareholder" of a Controlled Foreign Corporation ("C.F.C.") includes income in one year but receives distributions in another.

This article explains the labyrinth of the foreign tax credit provisions that are encountered to ensure that (i) foreign source income and (ii) related foreign taxes are reported in the same foreign tax credit basket. If not computed properly, doubled taxation of income is sure to arise.

BACKGROUND

Here is a typical fact pattern involving a U.S. citizen who is a shareholder of a foreign owner-managed business.

- Mr. A is a U.S. citizen who is the sole shareholder of F Co, a corporation organized in country F.
- F Co serves as a holding company that has invested in several operating and investment companies outside the U.S.
- The ownership percentage of F Co in the foreign entities ranges between 1% and 50%.
- Dividends from the lower-tier foreign entities comprise F Co's main source of income.
- An income tax treaty is in effect between Country F and the U.S.
- The foreign entities timely distribute dividends to F Co.
- The divided income is treated as Subpart F income for Mr. A.
- Country F imposes a withholding tax rate of greater than 20% on distributions by F Co to Mr. A.
- F Co has not invested in any property in the U.S.

GENERAL OVERVIEW

General Rules

F Co is a C.F.C. for U.S. tax purposes. A C.F.C. is a foreign corporation of which more than 50% of its authorized and outstanding shares, measured by total voting power or value, is owned by one or more "U.S. Shareholders." A U.S. Shareholder is a U.S. person that owns shares representing 10% or more of the value or the voting rights of all shares of the foreign corporation.

Broadly speaking, a U.S. Shareholder of a C.F.C. is required to include in U.S. taxable income its *pro-rata* share of the income of the C.F.C. The income inclusion is required even though no actual distribution is made by the C.F.C. The income inclusion typically takes either of two forms, Subpart F income or Global Intangible Low-Taxed Income ("G.I.L.T.I.").[1] Subpart F income typically includes passive income, for example, dividends, royalty, interest, royalty, etc. It also includes Foreign Base Company Income arising from related party transactions.[2] Whereas G.I.L.T.I. refers to the excess of the income of the C.F.C. over certain deductions, including

- a deduction for Subpart F income,[3]
- a deduction for certain income specifically excluded from Subpart F Income,[4]
- a deduction for dividends from certain related parties,[5]
- a deduction for expenses (including taxes) properly allocable to tested gross income under G.I.L.T.I.,[6] and
- a deduction for a hypothetical yield generated by the C.F.C. on its Qualified Business Asset Investment ("Q.B.A.I.").[7]

Application to Mr. A

Applying the Subpart F and G.I.L.T.I. rules to F Co, we see the following:

- F Co is a holding company and its income arising from dividends received from foreign entities would result in immediate U.S. taxation for Mr. A under the Subpart F provisions of U.S. tax law, except to the extent an exception applies.
- To the extent Mr. A is taxed immediately in the U.S. on income of F Co, subsequent distributions received from F Co will be viewed to be distributions of

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1 Other types of tax that may be imposed on a U.S. Shareholder of a C.F.C. include the Transition Tax for pre-2018 accumulated earnings and the tax on investments of earnings in U.S. property.

2 Foreign Base Company Sales Income (Code §954(d) and Foreign Base Company Services Income (e).

3 Code §951A(c)(2)(A)(i)(II).

4 Code §951A(c)(2)(A)(i)(III).

5 Code §951A(c)(2)(A)(i)(IV).

6 Code §951A(c)(2)(A)(ii).

7 Code §951A(b)(1)(B).

previously taxed income (“P.T.I.”) for U.S. tax purposes. A distribution of P.T.I. is not subject to U.S. tax a second time.[8]

- Nonetheless, the distribution will be taxed in Country F at the time a distribution is made by F Co to Mr. A.
- In the year of distribution, Mr. A would also have a Subpart F inclusion for that year.

ORDERING RULE TO DETERMINE THE SOURCE OF ACTUAL DISTRIBUTIONS

General Rules

When a distribution is made by a C.F.C. to a U.S. Shareholder, it is important to determine the source of the distribution to determine the extent to which the distribution represents P.T.I. and non-P.T.I. As mentioned above, a distribution made by a C.F.C. to a U.S. Shareholder is not subject to U.S. tax on receipt if, and to the extent, it represents P.T.I.[9] P.T.I. broadly describes the income of a C.F.C. that has already been subject to U.S. tax in the hands of a U.S. Shareholder under any of the anti-tax deferral regimes that exist under U.S. tax law, namely Subpart F, G.I.L.T.I., Transition Tax, and investments of earnings in U.S. property.

“When a distribution is made by a C.F.C. to a U.S. Shareholder, it is important to determine the source of the distribution to determine the extent to which the distribution represents P.T.I. and non-P.T.I.”

When an actual distribution is made by a C.F.C., it is important to determine its source for the following reasons:

- To determine the extent to which the distribution represents P.T.I. and the particular category of P.T.I. from which the distribution is deemed made
- To determine the U.S. tax treatment of the distribution based on the P.T.I. category it represents
- To properly adjust the P.T.I. categories to ensure that each category reflects the appropriate residual amount of P.T.I.

P.T.I. is classified into several categories based on the anti-tax deferral regimes. The following set of ordering rules is followed to determine the category of P.T.I. that serves as the source of the distribution:[10]

- First, the distribution is deemed to come from E&P that has been taxed to the U.S. Shareholder as investments of earnings in U.S. property (“U.S. Property P.T.I. E&P”).[11]
- Second, to the extent the distribution exceeds the U.S. Property P.T.I. E&P, the distribution is deemed to come from the E&P that has been taxed to

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[8] Code §959(b).

[9] Code §959(a).

[10] *Ibid.*

[11] Code §959(c)(1).

the U.S. Shareholder as Subpart F Income and G.I.L.T.I.[12] ("Subpart F P.T.I. E&P") on a *pro-rata* basis.[13]

> The amount subject to the Transition Tax is treated as an increase in Subpart F income ("Transition Tax P.T.I. E&P"). The amount is treated as included in the shareholder's gross income under Code §951(a) for purposes of Code §959.
>
> The Transition Tax P.T.I. E&P is given priority when determining the group of P.T.I. from which a distribution is made.[14] This implies that the distribution is first deemed to be made out of the Transition Tax P.T.I. E&P until it is fully exhausted under the Subpart F P.T.I. E&P. Thereafter, it is allocated to the residual distribution among Subpart F and G.I.L.T.I.

- To the extent the distribution exceeds the foregoing two categories, the distribution is deemed to come out the E&P that has not been previously subject to U.S. tax at the level of the U.S. Shareholder ("Non-P.T.I. E&P").[15]

Within each of the three types of E&P categories, a distribution is first allocated to the current year E&P and then to E&P from prior years going backward in sequential order, regardless of actual source of the distribution for accounting or corporate governance purposes.[16] In other words, a distribution is first allocated to the current year U.S. Property P.T.I. E&P, then to U.S. Property P.T.I. E&P of the immediately preceding year, followed by the second immediately preceding year, and so on so forth. The allocation continues in the backward order in the same P.T.I. category until either (i) the distribution amount is fully allocated or (ii) the P.T.I. in the P.T.I. E&P category is fully exhausted. Once the earning in the U.S. Property P.T.I. category is fully exhausted, the exercise of allocating the distribution amount continues under the Subpart F P.T.I. E&P category, starting with the current year, and going back to preceding years in a sequential order (giving the Transition Tax P.T.I. E&P priority). The exercise continues under the Non-P.T.I. E&P once the Subpart F P.T.I. E&P is depleted until the distribution amount is fully allocated.

Distributions to Mr. A out of the first two categories are excluded from the U.S. Shareholder's income. Distributions from Non-P.T.I. E&P are treated as taxable dividends. Taxable dividends are subject to U.S. tax in the hands of Mr. A rates of up to 20% if the dividends are treated as qualified dividends.[17] Dividends that are not qualified dividends are generally taxed at ordinary rates of tax that are capped at

[12] Code §951A(f)(1)(A).

[13] Code §965(b)(4)(A).

[14] Section 3.2 of Notice 2019-1.

[15] Code §959(c)(3).

[16] Treas. Reg. §1.959-3(b).

[17] Dividends distributed by a foreign corporation are treated as qualified dividends if (i) the foreign corporation is eligible for benefits under a comprehensive income tax treaty between the U.S. and the foreign corporation's country of residence, (ii) the determines the treaty is satisfactory, and (iii) the treaty includes an exchange of information program. See Code §1(h)(11)(c)(II). In no event is a dividend treated as a qualified dividend if the foreign corporation distributing the dividend a P.F.I.C. a surrogate foreign corporation under the anti-inversion rules. See Code §1(h)(11)(C)(iii)(I) and (II).

37% under current law, except that excess distributions received from a P.F.I.C. are taxed under the P.F.I.C.[18] rules. Additionally, dividends are subject to the Net Investment Income Tax imposed at the rate of 3.8%.

Application to Mr. A

F Co has never invested in property in the U.S. and therefore, no portion of its E&P represents U.S. Property P.T.I. E&P. Therefore, any distribution made by F Co to Mr. A in 2025 would be deemed first to be made out of the 2025 Subpart F P.T.I. E&P. Any distribution in excess of the 2025 Subpart F P.T.I. E&P would be deemed to be made from the immediately preceding year's Subpart F P.T.I. E&P and so on and so forth. Mr. A would not be subject to U.S. tax on the distributions as long as the distributions represent the Subpart F P.T.I. E&P.

While the distribution would not be subject to U.S. income tax, Mr. A. would be subject to local withholding tax. At the same, Mr. A would be subject to U.S. income tax on Subpart F inclusion for the year of distribution.

FOREIGN TAX CREDIT COMPLEXITY

Background

The second issue that is faced by Mr. A is whether the foreign tax on the distribution by F Co to Mr. A can be claimed as a foreign tax credit in order to reduce or eliminate U.S. tax on the Subpart F inclusion for the year of the distribution.

F Co is a holding company and its income arising from dividends received from subsidiaries would result in immediate U.S. taxation for Mr. A under the Subpart F provisions of U.S. tax law, except to the extent an exception applies. To the extent Mr. A is taxed immediately in the U.S. on income of F Co, subsequent distributions from F Co will be viewed to be distributions of P.T.I. for U.S. tax purposes. As mentioned above, a distribution of P.T.I. is not subject to U.S. tax a second time. Nonetheless, the distribution will be subject to tax in Country F at the time Mr. A receives a dividend from F Co. For Mr. A to obtain a benefit under the foreign tax credit, his adviser must have an understanding of the way in which the foreign tax credit limitation works.

General Rules

Broadly speaking, the foreign tax credit rules impose the following limitations on a taxpayer's ability to claim a credit for foreign income taxes paid against the U.S. tax liability arising from a transaction:

- The foreign tax credit reduce U.S. Federal income tax on foreign source income, only.
- The U.S. Federal income tax on income in a particular F.T.C. basket can be reduced only by foreign income taxes imposed on the income in that basket. As a result, foreign taxes in one basket cannot be used to offset U.S. Federal income tax on income in another basket.

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[18] See Code §1291 *et seq*.

- After 2017, five foreign tax credit baskets exist for most individuals:
  - The general F.T.C. basket
  - The passive F.T.C. basket
  - The foreign branch F.T.C. basket
  - The G.I.L.T.I. F.T.C. basket
  - The F.T.C. basket for income resourced under a provision of a particular income tax treaty

The issue at hand is to determine which of the above F.T.C. baskets applies when U.S. tax on foreign source income of a U.S. individual is determined in one year under Subpart F but foreign income tax on dividend income is imposed in a following year when a dividend distribution is paid to the U.S. individual. The problem arises because foreign taxes imposed on income in one basket cannot be used to reduce U.S. tax on income in a second basket. Cross-crediting of foreign taxes among F.T.C. baskets is not permitted. Ignoring timing differences, in order for the foreign tax that is imposed on the dividend income to offset the U.S. individual's U.S. tax on the Subpart F inclusion from the C.F.C. for the same year, the dividend and the Subpart F inclusion must fall in the same basket for F.T.C. purposes.

Look-through Rules Determine F.T.C. Baskets for Dividends and Subpart F Income

Generally, dividends received by a U.S. Shareholder from a C.F.C. are not automatically treated as passive category income.[19] Rather, the general rule is replaced by the application of the look-through rules that classify the character of the dividend by looking through to the types of income earned by the C.F.C.

Look to the Earnings and Profits of the Distributing Entity to Determine the Reportable Category of Income for the Recipient of Dividends

When a U.S. Shareholder receives a dividend from a C.F.C., the earnings and profits from which the dividend is paid are examined. The U.S. Shareholder must allocate the dividend to a separate category based on the ratio of the earnings and profits attributable to income in that category to the total earnings and profits. In particular, dividends paid out of the earnings and profits of a C.F.C. to its U.S. Shareholder is treated as passive category income in proportion to the ratio of the portion of earnings and profits attributable to passive category income to the total amount of earnings and profits of the C.F.C.[20] If C.F.C. does not have any passive income, all of the dividends are general category unless a separate category applies.

The Code and the regulations do not clearly define the meaning of "total" when applied to earnings and profits. It appears that the word refers to the earnings and profits from the year or years from which the dividend is paid.[21]

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19 Code §904(d)(3)(A); Treas. Reg. §1.904-5(b)(1).

20 Code § 904(d)(3)(D).

21 Treas. Reg. §1.904-5(c)(4)(iii), Ex. 1

The dividends for the look through rule include actual dividends distributed, undistributed C.F.C. earnings that are taxed to a U.S. Shareholder under Subpart F because the C.F.C. has invested them in U.S. property, and gains on sales of C.F.C. stock that are treated as dividends under Code §1248.[22]

Dividends Subject to High Tax Exception (90%) are not Passive Notwithstanding the Look-Through Rules

If a C.F.C. has income that would otherwise be in the passive category, but the C.F.C. is taxed on the income by foreign countries at an effective rate higher than 90% of the maximum U.S. corporate rate, earnings and profits "attributable to" the income are removed from the passive basket and are either general limitation income or income in a specified separate category.[23] The rule applies only if the U.S. Shareholder proves the effective rate to the I.R.S.'s satisfaction.[24] At the present time, the U.S. corporate tax rate is 21%, thus, the dividend reclassification rule would apply if the C.F.C. is subject to a foreign income tax at an effective rate exceeding 18.9%.

Look-Through Rules for Certain Distributions Received in a Multi-Tiers Structure

Look-through rules apply in a multi-tier structure when the entities are related to each other. In effect, this means that the dividend income to the receiving entity is determined with reference to the E&P of the distributing entity[25] when dividends are received from a related entity ("Related Look-Through Entities"). For this purpose, two foreign corporations are considered Related Look-Through Entities if the same person is a U.S. Shareholder of both foreign corporations.[26]

> *Example:*
>
> U.S.P., a domestic corporation, owns two foreign subsidiaries, F1 and F2. F3, is a foreign corporation in which F2 owns 40% of the stock and the remainder is owned by a U.S. person unrelated to U.S.P. If F2 receives dividends from F3, the look-through rules apply to the dividends because U.S.P. is a U.S. Shareholder of both F2 (directly) and F3 (indirectly).[27] Therefore, the category of F2's dividend income is determined with reference to F3's E&P.

The dividend look-through rule between Related Look-Through Entities applies even if one or more entities are not C.F.C.s. Thus, if the balance 60% of the ownership interest in F3 is held by a non-U.S. person, the dividend look-through rule would nonetheless apply even though F3 is not C.F.C to characterize the dividend received by F2 from F3. This characterization may then pass through to U.S.P. by a second application of the look-through rules. For example, if *F2's* dividend is Subpart F income to U.S.P., the Subpart F income will be allocated among different categories of income for F.T.C. purposes in proportion to the categorization of the dividends under the dividend look-through rule. *(The application of the look-through rule applicable to Subpart F income is explained below).*

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22 Code §904(d)(3)(G); Treas. Reg. §§1.904-5(c)(4)(i); 1.904-5(c)(7) Ex. 2.

23 Code §904(d)(3)(E); Treas. Reg. §1.904-5(d)(2).

24 Treas. Reg. §1.904-5(d)(2).

25 Treas. Reg. §1.904-5(k)(1).

26 Treas. Reg. §1.904-5(i)(3).

27 Treas. Reg. §1.904-5(i)(5) Ex. 2.

Subpart F Inclusion

The Character of a C.F.C.'s Subpart F Income Flows Through to the U.S. Shareholder; Thereby Implying that the Subpart F Inclusion is Treated as Passive-Basket Income to the Extent it is Attributable to Passive Income of the C.F.C.

The character of a C.F.C.'s Subpart F income flows through to the U.S. Shareholder.[28] In other words, if a U.S. Shareholder has a Subpart F inclusion, the foreign tax credit limitation category of the inclusion depends on the nature of the income that produced it. Subpart F inclusion is treated as passive-basket income if attributable to passive income of the C.F.C., otherwise, it is deemed to be general category income or income in a specified separate category under the F.T.C. rules.[29] This tracing rule looks specifically to the income that caused the inclusion under Section 951(a)(1)(A). In comparison, the dividend look-through rule takes into account all of the income of the C.F.C.

> *Example:*[30]
>
> U.S. Co wholly owns C.F.C. In Year 1, C.F.C. earns $100x of net income, $85x of which is general category foreign base company sales income and $15x of which is passive category foreign personal holding company income. No foreign tax is imposed on income. C.F.C.'s income of $100x is Subpart F income taxed currently to U.S.P. under section 951(a)(1)(A). Because $15x of the Subpart F inclusion is attributable to passive category income of C.F.C., the inclusion is passive category income to U.S. Co. The remaining $85x Subpart F inclusion is general category income to U.S. Co.

Interplay of the Dividend and Subpart F Look Through Rules

Example[31]

Facts

U.S. Co, a domestic corporation, owns all of the stock of C.F.C. 1. In turn, C.F.C. 1 owns 40% of the stock of C.F.C. 2, a Country X corporation. The remaining 60% of the stock of C.F.C. 2 is owned by V, a domestic corporation, unrelated to U.S. Co. C.F.C. 2 owns 40% (by vote and value) of the stock of C.F.C. 3, a Country Z corporation. The remaining 60% of C.F.C. 3 is owned by unrelated U.S. persons. C.F.C. 3 earns exclusively general category income that is neither Subpart F income nor tested income. In Year 1, C.F.C. 3 made a dividend distribution of $50x to C.F.C. 2.

Analysis

1. Application of the dividend look-through rule

    a. The nature of income for F.T.C. purposes will be ascertained first at the level of C.F.C. 2 before analyzing the treatment in the hands of U.S. Co.

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28 Code §904(d)(3)(B).

29 Treas. Reg. §1.904-5(c)(5).

30 Treas. Reg. §1.904-5(c)(7)(i).

31 Treas. Reg. §1.904-5(i).

b. The dividend look-through rule would apply only if C.F.C. 2 and C.F.C. 3 are Related Look-Through Entities. If so, the nature of the dividend income in the hands of C.F.C. 2 for F.T.C. purposes would be ascertained with reference to C.F.C. 3's E&P.

i. U.S. Co indirectly owns more than 10% of the voting power of all classes of stock of both C.F.C. 2 (40%) and C.F.C. 3 (16%). Accordingly, C.F.C. 2 and C.F.C. 3 have the same U.S. Shareholder in common.

ii. Because C.F.C. 2 and C.F.C. 3 have a common U.S. Shareholder, C.F.C. 2 and C.F.C. 3 are Related Look-Through Entities. Accordingly, the dividend look-through rules would apply.

iii. Because C.F.C. 3 has no passive category income or earnings and profits, the dividend income is characterized as general category income to C.F.C. 2.

c. Treatment of the dividend received by C.F.C. 2 in the hands of U.S. Co under the Subpart F look-through rule.

i. The dividend is Subpart F income of C.F.C. 2 that is taxable to U.S. Co.

ii. The Subpart F look-through rules pass on the character of a C.F.C.'s Subpart F income to its U.S. Shareholder.[32] Accordingly, the Subpart F inclusion of U.S. Co is general category income.

Example[33]

Facts

U.S. Co, a domestic corporation, owns 50% of the voting stock of C.F.C. 1. In turn, C.F.C. 1 owns 10% of the voting stock of C.F.C. 2. The remaining 50% of the stock of C.F.C. 1 is owned by X. The remaining 90% of the stock of C.F.C. 2 is owned by Y. X and Y are each U.S. Shareholders of C.F.C. 2, but are not related to U.S. Co, C.F.C. 1, or each other. In Year 1, C.F.C. 2 pays a $100x dividend to C.F.C. 1.

Analysis

1. Application of the dividend look-through rule

a. The nature of income for F.T.C. purposes will be ascertained first at the level of C.F.C. 1 before analyzing the treatment in the hands of U.S. Co.

b. The dividend look-through rule would apply only if C.F.C. 1 and C.F.C. 2 are Related Look-Through Entities. If so, the nature of the dividend income in the hands of C.F.C. 1 for F.T.C. purposes would be ascertained with reference to C.F.C. 2's E&P.

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32 Code §904(d)(3)(B).

33 Treas. Reg. §1.904-5(i)(5)(iv).

i. U.S. Co directly owns more than 10% of the voting power and value of C.F.C. 1. However, it only owns 5% of the voting power of all classes of stock of C.F.C. 2 through C.F.C. 1.

ii. X directly owns more than 10% of the voting power and value of C.F.C. 1. However, it does not own any interest in C.F.C. 2.

iii. Therefore, C.F.C. 1 and C.F.C. 2 are not Related Look-Through Entities because no person is a U.S. Shareholder of both C.F.C. 1 and C.F.C. 2.

iv. Because C.F.C. 1 and C.F.C. 2 are not Related Look-Through Entities, the dividend look-through rule should not apply.

v. Under the general rule for categorizing income into baskets for F.T.C. purposes, dividends are treated as passive income.[34]

"In the facts presented at the beginning of the article, two F.T.C. baskets are in play."

c. No exception to the Subpart F inclusion applies with respect to the dividends distributed by C.F.C. 2 to C.F.C. 1.[35] Therefore, the dividends represent Subpart F income of C.F.C. 1 that is taxable to U.S. Co.

d. Under the Subpart F look-through rule, a Subpart F inclusion is treated as passive-basket income if attributable to passive income of the C.F.C. Because the dividend income is characterized as Foreign Personal Holding Company Income, it is passive category income for U.S. Co.[36]

APPLICATION OF THE LOOK-THROUGH RULES TO MR. A

In the facts presented at the beginning of the article, two F.T.C. baskets are in play. The first is the basket in which the Subpart F Income that arises from F Co's investments is placed. The second is the basket to which the distributions from F Co and corresponding foreign withholding tax are placed.

Foreign Tax Credit Basket of Subpart F Income

- As explained above, the F.T.C. basket of the dividend distributed to F Co by the underlying entities must be ascertained before analyzing the treatment of Subpart F income in the hands of Mr. A.
- The dividend look-through rule would apply to the extent F Co and the underlying entities are Related Look-Through Entities. If the two entities are related, then the F.T.C. basket of the dividend income in the hands of F Co would be ascertained with reference to the E&P of the underlying distributing entity.
- Mr. A owns 100% of F Co. Therefore, F Co would be treated as related to each underlying entity in which it owns at least 10% of the voting rights or

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34 Code §904(d)(2)(B)(i).

35 Because CFC2 is not a related person to CFC1 within the meaning of section 954(d)(3), section 954(c)(3) and (c)(6) are inapplicable and therefore no exception to Subpart F inclusion applies.

36 Code §904(d)(2)(B)(i) and Treas. Reg. §1.904-4(b)(2)(i)(A).

value. Consequently, the underlying entity and F Co would have Mr. A as a common U.S. Shareholder. Therefore, the dividend look-through rule would apply.

- The dividend look-through rule looks to the E&P of the distributing entity and the dividend is allocated between passive and general category in proportion to each type of income generated by the distributing entity. Thus, assume the underlying entity is a holding company that earns only passive income. The dividends in the hands of F Co would be placed in the passive income basket for F.T.C. purposes.

- No exception to Subpart F inclusion applies with respect to the dividends distributed by the underlying entity to F Co. Accordingly, the dividend is Subpart F income of F Co that is taxable to Mr. A.

- Under the Subpart F look-through rule, a Subpart F inclusion is treated as passive-basket income to the extent attributable to passive income of the C.F.C. Because the dividend income is foreign personal holding company income, Subpart F income is passive category income to Mr. A.

Applicable Foreign Tax Credit Basket to Distributions from F Co to Mr. A When the High Tax Kickout Rule does not Apply

- The dividend look-through rule would be applied once again to determine the F.T.C. basket of the dividends distributed by F Co to Mr. A.

- Since F Co is a holding company with only passive income, the entire dividend distribution from F Co to Mr. A would be reported under the passive income basket. As a result, any withholding tax in Country F would be viewed as a tax under the passive income basket.

Since U.S. tax law places both the Subpart F income and the foreign withholding tax on the distribution to Mr. A in the passive basket, Mr. A would be allowed to offset his U.S. tax liability on Subpart F income by the withholding tax paid in Country F.

Applicable Foreign Tax Credit Basket to Distributions from F Co to Mr. A is Determined at the Level of Mr. A Under the High Tax Kick Out Rule

High Tax Kick out ("H.T.K.O.") Rule

Income received or accrued by a U.S. person that would otherwise be passive income is not treated as passive income if the income is determined to be high-taxed income at the level of the U.S. person.[37] Income is considered to be high-taxed income if, after allocating expenses, losses, and other deductions, the sum of the foreign income taxes paid or accrued, and deemed paid, by the U.S. person with respect to such income exceeds the highest rate of tax specified in Code §1 for an individual multiplied by the amount of such income (including any gross up under Code §78).[38] Ambiguity exists in the statue as to whether the highest rate of tax

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37 Treas. Reg. §1.904-4(c)(1).

38 The H.T.K.O. rule is distinct from the high-tax exception in that the former relates to the income tax in the hands of the shareholder when a distribution is made by the foreign corporation. On the other hand, the high-tax exception relates to the foreign tax paid by the foreign corporation on its income.

under Code §1 is to be taken literally. If so, the H.T.K.O. is triggered if the rate is 37% (the maximum tax rate for ordinary income individuals under current law), or the rate specified for qualified dividends, which is 20%.

At the risk of being repetitious, the H.T.K.O. rule is applied at the U.S. Shareholder level, not at the C.F.C. level.[39] Income that is passive under the applicable rules (before applying the H.T.K.O. rule) received by the C.F.C. is not reclassified as general category income at the C.F.C. level but will retain its passive character under the look-through rules when it passes to the U.S. Shareholder. The H.T.K.O. rule then applies at the level of the U.S. Shareholder to determine whether the income retains its passive status or is moved to the general category. For example, if a foreign tax is imposed on a dividend distribution from a C.F.C. to its U.S. Shareholder that is viewed as passive income under the dividend look-through rule, the dividend should retain its look-through character as passive income unless the foreign tax is high enough to trigger the high tax kick out at the U.S. Shareholder level, taking into account the allocation of expenses. If so, the income would be treated as a general category income for the U.S. Shareholder.[40]

If the withholding tax rate in Country F on dividends is greater than 20%, and assuming that is the triggering rate of tax for applying the H.T.K.O. rule, the F.T.C. basket for the dividends would be altered. So, let's assume the withholding tax rate in Country F is 25%. Since the tax rate on dividends in Country F is higher than the highest tax rate in the U.S. on qualified dividends (20%), the income is treated as high-taxed income. On the other hand, it could be argued that the triggering rate for application of the H.T.K.O. rule is 37%. Under this view the H.T.K.O. rule would not be triggered.

U.S. tax regulations[41] address the issue in the following way:

1. Any increase in taxes paid when a taxpayer receives an amount excluded from income under the P.T.I. provisions generally are not considered in judging whether the original inclusion as Subpart F income was high-taxed income.[42] Thus, additional taxes triggered by an actual distribution do not require a redetermination of the treatment of the originally included Subpart F income.

2. The next issue is to determine which basket receives the foreign taxes paid in the later year in which the taxpayer receives a P.T.I. distribution.[43]

3. If the original inclusion was H.T.K.O. income, the later taxes fall in the general basket.[44] In other words, the later taxes are treated as additional "high taxes," which are subject to the H.T.K.O. rule.

39 Code §904(d)(3)(F)(i).

40 See H.R. Rep. No. 100-795, at 214 (1988).

41 Treas. Reg. §1.904-4(c)(6)(iii).

42 Treas. Reg. § 1.904-4(c)(6)(i).

43 Treas. Reg. § 1.904-4(c)(6)(iii)

44 *Ibid.*

4. If the item of income is not considered to be high-taxed income in the year in which Subpart F income is recognized, the taxpayer treats the increase in foreign taxes imposed on subsequent distributions in the following way.

   a. First, the gross income in the year of inclusion under Subpart F is multiplied by the highest rate of tax in Code §11, currently 21%. The foreign tax paid in the year of distribution to the extent of the amount so determined is treated as foreign taxes paid or accrued on passive category income.

   b. Second, taxes paid or accrued on the distribution in excess of the foregoing amount are treated as taxes related to the same category of income to which such inclusion would have been assigned had the income been treated as high-taxed income in the year of inclusion. The choices are general category income or Code §951(A) income.

   c. If these additional taxes are not creditable in the year of distribution, the carryover rules of Code § 904(c) apply. Note that no carryover is permitted regarding excess foreign taxes imposed on income taxed under Code §951A.

Therefore, Mr. A is subject to the H.T.K.O. rule as follows:

1. No foreign income taxes are paid by Mr. A in the year income is included on a U.S. tax return by reason of Subpart F.

2. In the subsequent year, when Mr. A receives an actual dividend from F Co, a portion of the income will be passive basket income, and a portion of the income will be treated as general basket income. Assuming a tax rate of 25% and a distribution from F Co of $100, the basket computation is as follows:

   a. Mr. A reports Subpart F income in year 1, when F Co recognizes net dividend income in the amount of $100. The income is passive is basket income for foreign tax credit purposes. There are no foreign taxes to take into account.

   b. Mr. A reports foreign taxes in year 2, when the dividends are distributed by F Co. In that year, he incurs foreign tax of $25. Of that amount, $21 is allocated to the passive F.T.C. basket and $4 is allocated to the general F.T.C. basket.

   c. If the facts of years 1 and 2 are repeated in years 2 and 3, so that F Co receives the same amount of dividend income in year 2 and distributes the same amount of dividends to Mr. A in year 3, the foreign taxes paid in year 2 by Mr. A in connection with the dividend he receives in year 2 should be available to offset the U.S. taxes in year 2 that are imposed on the passive basket Subpar F income in year 2.

   d. If in year 2, F Co receives no dividends, the unused foreign income taxes of Mr. A that are in the passive F.T.C. basket for year 2 are available to be carried back and claimed as a credit against U.S. tax on passive income in year 1.

CONCLUSION

As mentioned at the beginning of this article, the foreign tax credit provisions are among the most complicated areas of the Code, especially for U.S. individuals who are U.S. Shareholders for Subpart F purposes. One might say that the applicable I.R.S. regulations provide guidance only to those having a full understanding of the rules prior to reading the regulations.

"One might say that the applicable I.R.S. regulations provide guidance only to those having a full understanding of the rules prior to reading the regulations."

NEW B.O.I. REGULATIONS UNDER THE C.T.A. ARE ISSUED BY FINCEN

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Tags
B.O.I.
C.T.A.
FinCEN

INTRODUCTION

On Friday, March 21, 2025, the Financial Crimes Enforcement Network ("FinCEN") of the Treasury Department published interim final rule to narrow the existing beneficial ownership information ("B.O.I.") reporting requirements under the Corporate Transparency Act (the "C.T.A."). Entities previously defined as "domestic reporting companies" are exempted from the reporting requirements and do not have to report B.O.I. to FinCEN, or update or correct B.O.I. previously reported to FinCEN. With limited exceptions, the interim final rule does not change the existing requirement for foreign reporting companies to file B.O.I. reports. However, the deadline to file initial B.O.I. reports, and to update or correct previously filed B.O.I. reports, are extended to 30 days from the date of publication to give foreign reporting companies additional time to comply. Note, however, the interim final rule exempts foreign reporting companies from having to report the B.O.I. of U.S. persons who are beneficial owners and exempts U.S. persons from having to provide such information to foreign reporting companies.

As a service to our readers, particularly those based outside the U.S., below are significant excerpts from the preamble of the FinCEN interim regulations with footnotes deleted.

EXCERPTS FROM THE PREAMBLE TO THE REGULATIONS

Supplementary Information

Background

On January 1, 2021, Congress enacted into law the C.T.A. as part of the broader Anti-Money Laundering Act of 2020. Section 6403 of the C.T.A., among other things, amends the Bank Secrecy Act (BSA) by adding a new section 5336, Beneficial Ownership Information Reporting Requirements, to subchapter II of chapter 53 of title 31, United States Code. This section established new B.O.I. reporting requirements for many corporations, limited liability companies, and other similar entities operating in the United States. The C.T.A. excludes from that general definition, however, specified categories of businesses. The C.T.A. also authorizes the Secretary of the Treasury (Secretary) to exempt any other "entity or class of entities" for which the Secretary, with the written concurrence of the Attorney General and the Secretary of Homeland Security, has, by regulation, determined that "requiring beneficial ownership information from the entity or class of entities . . . would not serve the public interest" and "would not be highly useful in national security, intelligence, and law enforcement agency efforts to detect, prevent, or prosecute money laundering, the financing of terrorism, proliferation finance, serious tax fraud, or other crimes." In addition, section 5318(a)(7) of the BSA provides that the Secretary may make appropriate exemptions from a requirement in the BSA or regulations prescribed under the BSA. Taken together, these provisions authorize the issuance of regulations that may provide additional exemptions from the requirements of the C.T.A..

* * *

Section 1010.380 previously required domestic reporting companies and foreign reporting companies created or registered to do business in the United States before the rule's effective date of January 1, 2024, to file initial B.O.I. reports with FinCEN by January 1, 2025, one year after the effective date of the regulations. Domestic reporting companies created in 2024 and those foreign reporting companies registered to do business in the United States in 2024 had 90 days to file their initial B.O.I. reports with FinCEN. Starting on January 1, 2025, section 1010.380 provided all reporting companies created or registered on or after that date with 30 days to file their initial reports.

The January 1, 2025, deadline previously established in FinCEN's regulations has changed in light of litigation challenging the C.T.A.. In two cases, district courts issued universal orders that preliminarily enjoined FinCEN from implementing and enforcing the C.T.A. and the Reporting Rule or stayed the effective date of section 1010.380 on a nationwide basis. First, on December 3, 2024, in Texas Top Cop Shop, Inc. v. Bondi, the U.S. District Court for the Eastern District of Texas, Sherman Division, issued an order that preliminarily enjoined the government from enforcing the C.T.A. and stayed its implementing regulation's reporting deadlines. The government appealed and separately sought a stay of the district court's order pending that appeal, and on January 23, 2025, the Supreme Court granted a stay pending appeal of that order. Second, on January 7, 2025, in Smith v. U.S. Department of the Treasury, the U.S. District Court for the Eastern District of Texas, Tyler Division, issued a similar preliminary order that prevented the government from enforcing the C.T.A. against the plaintiffs and stayed the effective date of the implementing regulation during the pendency of that litigation. The government appealed and sought a stay of this order, which the district court granted on February 18, 2025. The district court's stay of its order lifted the last remaining nationwide order preventing FinCEN from implementing and enforcing the C.T.A. and section 1010.380.

Recognizing that the reporting deadlines set by section 1010.380 for many companies had already passed while those deadlines were stayed by court order and that companies would need additional time to comply, FinCEN extended the reporting deadlines for most reporting companies until March 21, 2025.15 In addition, FinCEN announced that during the 30-day extension period, it would "assess its options to further modify deadlines, while prioritizing reporting for those entities that pose the most significant national security risks." On March 2, 2025, Treasury announced the suspension of enforcement of the C.T.A. against U.S. citizens, domestic reporting companies, and their beneficial owners, and Treasury further announced its intent to engage in a rulemaking to narrow the Reporting Rule to foreign reporting companies only.

The Interim Final Rule

Overview of Rule

* * *

First, this interim final rule exempts all domestic reporting companies, and their beneficial owners, from the requirement to file initial B.O.I. reports, or to update or correct previously filed B.O.I. reports, by excluding domestic companies from the scope of the term "reporting company," pursuant to a determination made by the Secretary under 31 U.S.C. 5336(a)(11)(B)(xxiv). The rule text provides for this change by redefining the term "reporting company" at 31 CFR 1010.380(c) to remove the previously defined term "domestic reporting company" at 31 CFR 1010.380(c)(1)(i). By taking this step, any entity that meets the definition of the previously defined term "domestic reporting company" is no longer within the scope of the Reporting Rule. Moreover, FinCEN is adding an exemption to the list of exempted entities at 31 CFR 1010.380(c)(2). This exemption * * * applies to "any entity that is: (A) a corporation, limited liability company, or other entity; and (B) created by the filing of a document with a secretary of state or any similar office under the law of a State or Indian tribe."

"First, this interim final rule exempts all domestic reporting companies, and their beneficial owners, from the requirement to file initial B.O.I. reports, or to update or correct previously filed B.O.I. reports, by excluding domestic companies from the scope of the term 'reporting company' . . ."

Second, this interim final rule exempts foreign reporting companies, and their U.S. person beneficial owners, from the requirement to provide the B.O.I. of any U.S. persons who are beneficial owners of the foreign reporting company. The rule text provides for this change by adding an exemption at 31 CFR 1010.380(d)(4)(i): "Reporting companies are exempt from the requirement in 31 U.S.C. 5336 and this section to report the beneficial ownership information of any U.S. persons who are beneficial owners." It also adds an exemption at 31 CFR 1010.380(d)(4)(ii): "U.S. persons are exempt from the requirements in 31 U.S.C. 5336 and this section to provide beneficial ownership information with respect to any reporting company for which they are a beneficial owner." Foreign reporting companies that only have beneficial owners that are U.S. persons will be exempt from the requirement to report any beneficial owners.

Related to the second exemption, this interim final rule revises the special rule associated with foreign pooled investment vehicles at 31 CFR 1010.380(a)(b)(2)(iii) to exempt foreign pooled investment vehicles from having to report the B.O.I. of U.S. persons who exercise substantial control over the entity. Under the special rule, foreign pooled investment vehicles that would be a reporting company but for the exemption at 31 CFR 1010.380(c)(2)(xviii), and are formed under the laws of a foreign country, are required to report beneficial ownership information solely with respect to an individual who exercises substantial control over the entity. If more than one individual exercises substantial control over the entity, the entity is required to report information with respect to the individual who has the greatest authority over the strategic management of the entity. FinCEN has revised the rule text such that foreign pooled investment vehicles must report the B.O.I. of an individual who exercises substantial control over the entity if that individual is not a U.S. person. If more than one individual exercises substantial control over the entity and at least one of those individuals is not a U.S. person, the entity must report information with respect to the individual who is not a U.S. person who has the greatest authority over the strategic management of the entity. If there is no individual with substantial control who is not a U.S. person, the foreign pooled investment vehicle is not required to report any beneficial owners.

This interim final rule otherwise retains the requirement for foreign reporting companies, and their beneficial owners (excluding U.S. persons), to report their B.O.I. to FinCEN, while extending the deadline for those companies to file initial B.O.I. reports, or update or correct previously filed B.O.I. reports, to 30 days after the date of this publication or 30 days after their registration to do business in the United States, whichever comes later.

FinCEN is accepting comments on this interim final rule. FinCEN will assess the exemptions, as appropriate, in light of those comments and intends to issue a final rule this year.

Exempting Domestic Companies

The C.T.A. recognizes that B.O.I. reporting requirements impose burdens on businesses. The C.T.A. therefore directs the Secretary to "minimize burdens on reporting companies associated with the collection of the information … in light of the private compliance costs placed on legitimate businesses." The C.T.A. also authorizes the Secretary to exempt from the reporting requirements "any entity or class of entities" if the Secretary, with the written concurrence of the Attorney General and the Secretary of Homeland Security, determines that "requiring beneficial ownership information from the entity or class of entities . . . would not serve the public interest" and "would not be highly useful in national security, intelligence, and law enforcement agency efforts to detect, prevent, or prosecute money laundering, the financing of terrorism, proliferation finance, serious tax fraud, or other crimes."

In issuing the Reporting Rule, FinCEN estimated the burdens imposed on businesses. FinCEN estimated the total aggregate labor costs for reporting companies filing initial B.O.I. reports in the first year of the Reporting Rule to be $21.7 billion and for reporting companies filing initial B.O.I. in future years to be $3.3 billion annually. FinCEN estimated the total aggregate labor costs for reporting companies filing updated B.O.I. reports in the first year to be $1.0 billion and in future years to be $2.3 billion. Estimates for the five-year average cost were $6.9 billion for initial reports and $2.0 billion for updated reports. FinCEN also noted that many comments stated that "the proposed reporting requirements are excessively onerous" and "focused on how the proposed reporting requirements might negatively affect small businesses." FinCEN further noted that multiple comments stated that "costs to comply with the proposed reporting requirements would hurt small businesses during financially difficult times." While explaining that it "is sensitive to concerns from small businesses about having to comply with a new set of regulations, and has endeavored to minimize unnecessary compliance burdens," FinCEN recognized that achieving the C.T.A.'s goal of collecting information that is "highly useful" while "minimiz[ing] burden on reporting companies" requires a "delicate balance."

On January 20, 2025, there was a change in presidential administrations, which has resulted in a reassessment of the balance struck by the Reporting Rule. On January 31, 2025, President Trump issued Executive Order (E.O.) 14192, Unleashing Prosperity Through Deregulation, which announced an Administration policy "to significantly reduce the private expenditures required to comply with Federal regulations to secure America's economic prosperity and national security and the highest possible quality of life for each citizen" and "to alleviate unnecessary regulatory burdens placed on the American people." Consistent with the exemptive authority provided in the C.T.A. and the direction of the President, the Secretary has reassessed the balance between the usefulness of collecting B.O.I. and the regulatory burdens imposed by the scope of the Reporting Rule.

The Secretary, with the written concurrence of the Attorney General and the Secretary of Homeland Security, has determined for purposes of this interim final rule that the reporting of B.O.I. by domestic reporting companies and their beneficial owners "would not serve the public interest" and "would not be highly useful in national security, intelligence, and law enforcement agency efforts to detect, prevent, or prosecute money laundering, the financing of terrorism, proliferation finance, serious tax fraud, or other crimes." The Secretary is aware that most domestic reporting companies that are not already covered by a statutory exemption are small businesses and that any regulations affecting them must recognize this fact. As the preamble to the Reporting Rule states, "[s]mall businesses are a backbone of the U.S. economy, accounting for a large share of U.S. economic activity, and driving U.S. innovation and competition." The vast majority of domestic small businesses are legitimate and owned by hard-working American taxpayers who are not engaged in illicit activity. The Secretary has assessed that exempting them would ensure that the Reporting Rule is appropriately tailored to advance the public interest, considering the burdens imposed by the regulations without sufficient benefits. The Attorney General and the Secretary of Homeland Security have concurred that collecting B.O.I. from domestic reporting companies would not be "highly useful in national security, intelligence, and law enforcement agency efforts." The Secretary's determination is also consistent with the direction of the President, including as set forth in E.O. 14192, Unleashing Prosperity Through Deregulation.

In conducting this reassessment, the Secretary has considered that failure to require B.O.I. reporting by domestic reporting companies could result in illicit finance risks, as Treasury has acknowledged. For example, the preamble to the Reporting Rule noted that Treasury's 2022 National Money Laundering Risk Assessments identified lack of timely access to B.O.I. as a key weakness within the U.S. anti-money laundering/countering the financing of terrorism (AML/CFT) regulatory regime. The preamble to the Reporting Rule also noted that while FinCEN's 2016 customer due diligence rule increased transparency by requiring covered financial institutions to collect a legal entity customer's B.O.I. at the time of an account opening, it did not address the collection of B.O.I. at the time of a legal entity's creation, and B.O.I. collected at the time of a legal entity's creation provides additional insight into the original beneficial owners of the entity. The Secretary has taken illicit finance risks into account in considering the usefulness of collecting B.O.I., the burdens such collection imposes on the public, and the public interest. Additionally, the Secretary has considered alternative sources of information to

mitigate risks. For example, the continuing requirement for covered financial institutions to collect a legal entity customer's B.O.I. at the time of account opening will serve to mitigate certain illicit finance risks associated with exempting domestic reporting companies from reporting their B.O.I..

Consistent with 31 U.S.C. 5336(a)(11)(B)(xxiv), and after conferring with the Department of Justice and the Department of Homeland Security and receiving written concurrences from the Attorney General and the Secretary of Homeland Security, the Secretary has directed FinCEN to issue this interim final rule exempting domestic reporting companies and their beneficial owners from the reporting requirements imposed through the Reporting Rule. The Secretary has also directed FinCEN to solicit comments on the approach taken in this interim final rule; the Secretary and FinCEN will assess this exemption, as appropriate, in light of those comments, and FinCEN intends to issue a final rule this year.

Reporting by Foreign Reporting Companies

Foreign reporting companies, however, present heightened national security and illicit finance risks and different concerns about regulatory burdens. Congress, through certain provisions in the C.T.A., recognized these heightened concerns about national security and illicit finance risks posed by foreign ownership or foreign control of reporting companies. Congress thus limited certain C.T.A. exemptions to companies that are exclusively domestic. For example, the C.T.A. requires that an entity be a "United States person" and be "beneficially owned or controlled exclusively by 1 or more United States persons that are United States citizens or lawfully admitted for permanent residence" to qualify for the B.O.I. reporting exemption for entities assisting a tax-exempt entity, 31 U.S.C. 5336(a)(11)(B)(xx). In addition, the C.T.A. states that the inactive entity reporting exemption, 31 U.S.C. 5336(a)(11)(B)(xxiii), is available only if an entity is not "owned by a foreign person, whether directly or indirectly, wholly or partially." These exemptions reflect Congress's intent to establish narrow, zero-threshold bars for foreign-owned or foreign-controlled entities, given heightened risks posed by companies with foreign ownership or control.

Throughout the rulemaking process implementing the C.T.A.'s reporting requirements, FinCEN has emphasized the risks of foreign illicit actors accessing the U.S. financial system through the use of legal entities created in foreign jurisdictions but registered to do business in the United States. For example, FinCEN noted that "[c]orrupt foreign officials, sanctions evaders, and narco-traffickers, among others, exploit the current gap in the U.S. B.O.I. reporting regime to park their ill-gotten gains in a stable jurisdiction, thereby exposing the United States to serious national security threats." FinCEN highlighted specific examples of significant criminal investigations into the use of shell companies throughout the world to launder money or evade sanctions imposed by the United States, including sanctions evasion by Iran through shell companies abroad.

Furthermore, on February 4, 2025, President Trump issued a National Security Presidential Memorandum (NSPM) addressing Iranian "behavior [that] threatens the national interest of the United States." This NSPM directs the Secretary to

> maintain countermeasures against Iran at the Financial Action Task Force, evaluate beneficial ownership thresholds to ensure sanctions deny Iran all possible illicit revenue, and evaluate whether financial institutions should adopt a "Know Your Customer's Customer" standard for Iran-related transactions to further prevent sanctions evasion.

Requiring B.O.I. reporting by foreign reporting companies is consistent with the actions regarding beneficial ownership that this NSPM directs the Secretary to take to address the national security threat arising from Iran.

The Financial Action Task Force (FATF) Report on the Concealment of Beneficial Ownership has also found that shell companies can be used in complex structures involving the distribution of assets across multiple companies in multiple jurisdictions. When these structures are used for illicit purposes, money may flow through multiple layers of shell companies before finally being withdrawn in cash or transferred to its final destination internationally. Of the cases analyzed by FATF that included shell companies, the majority included a corporation located in a foreign jurisdiction. Foreign companies registered to do business in the United States therefore pose a heightened risk to U.S. national security.

At the same time, foreign companies present fewer concerns regarding regulatory burdens that would not serve the public interest. Foreign companies are subject to the Reporting Rule only if they register to do business in the United States, thereby already filing a document in the United States. Moreover, E.O. 14192 announces a policy "to alleviate unnecessary regulatory burdens placed on the American people." The policy direction to minimize regulatory burdens placed on the American people can be achieved by exempting foreign reporting companies from having to report the B.O.I. of any U.S. persons who are beneficial owners of the foreign reporting company.

Consistent with the C.T.A.'s stated purposes, the C.T.A.'s exclusion of foreign reporting companies from certain other exemptions, the risks identified above, and the relative burdens, the Secretary has determined that exempting foreign companies would not serve the public interest. FinCEN is therefore continuing to require foreign reporting companies to report their B.O.I., except with respect to U.S. person beneficial owners. Foreign reporting companies that only have beneficial owners that are U.S. persons will be exempt from the requirement to report any beneficial owners.

__". . . FinCEN has decided to provide foreign companies with an additional 30 days to comply with the reporting requirements, recognizing that the reporting deadlines had been stayed by court order and were then extended by FinCEN, and that foreign companies will need advance notice of the new deadline."__

The Secretary has determined for purposes of this interim final rule that it would be appropriate to exempt U.S. persons from having to provide B.O.I. and, accordingly, to exempt foreign reporting companies from having to report the B.O.I. of any U.S. persons who are beneficial owners of a foreign reporting company. The Secretary has assessed that exempting U.S. persons' B.O.I. would ensure that the Reporting Rule is appropriately tailored to advance the public interest, considering the burdens imposed by the regulations without sufficient benefits. The Secretary's determination is also consistent with the direction of the President, including as set forth in E.O. 14192, Unleashing Prosperity Through Deregulation. In making this determination, the Secretary has considered that exempting reporting companies from reporting U.S. persons' B.O.I. could result in risks of evasion or illicit finance risks.

Consistent with 31 U.S.C. 5318(a)(7), the Secretary has therefore directed FinCEN to issue this interim final rule exempting foreign reporting companies from having to report the B.O.I. of any U.S. persons who are beneficial owners of a foreign reporting company. The Secretary has also directed FinCEN to solicit comments on the approach taken in this interim final rule; the Secretary and FinCEN will assess this exemption, as appropriate, in light of those comments, and FinCEN intends to issue a final rule this year. In addition, FinCEN has decided to provide foreign companies with an additional 30 days to comply with the reporting requirements, recognizing that the reporting deadlines had been stayed by court order and were then extended by FinCEN, and that foreign companies will need advance notice of the new deadline. * * *

About Us

Ruchelman P.L.L.C. is a boutique law firm based in New York City. It was founded in 1989 by an alumnus of a legacy firm that is now Deloitte's.

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