



Federal  
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FINANCE

# NOTIONAL INTEREST DEDUCTION: an innovative Belgian tax incentive

Tax Year 2013 - Income 2012



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## **Notional Interest Deduction: what is it?**

The so-called «notional interest deduction» is a new, innovative and powerful measure in international tax law enabling all companies subject to Belgian corporate tax to deduct from their taxable income a fictitious interest calculated on the basis of their shareholder's equity (net assets). The measure is valid from 1 January 2006 (tax year 2007). At the same time, the 0,5 % registration duty on capital contributions has been abolished (applicable from 1 January 2006).

### **Purpose**

The main purpose of this innovative measure is to reduce the tax discrimination between debt financing and equity financing. Indeed, in the case of loan capital, the interest paid is deductible from the taxable base, while with equity capital the dividends are taxable. With the gradual disappearance of the special tax schedule for Belgian coordination centres, Belgium had to provide another tax schedule allowing the further development of these types of coordination activities.

The new rules are also intended to have the following positive effects:

1. A general reduction of the effective corporate tax rate for all companies, and a higher return after tax on investment
2. The promotion of capital-intensive investments in Belgium, and an incentive for multinationals to examine the possibility of allocating such activities as intra-group financing, central procurement and factoring to a Belgian group entity.

### **Scope of application**

Eligible for the notional interest deduction are all companies that are subject to:

- ✓ Belgian corporate income tax; or
- ✓ Non-resident corporate income tax.

This means that the measure is applicable to:

- ✓ Belgian companies
- ✓ Belgian branches of foreign companies
- ✓ Non-profit organisations (international or national) and foundations subject to Belgian corporate income tax
- ✓ Foreign companies that own real estate located in Belgium or hold property rights in such real estate.

It excludes companies that already benefit from certain other advantageous tax rules:

- ✓ Recognised Belgian coordination centres that still benefit from the tax regime allowed by Royal Decree No.187 of 30 December 1982
- ✓ Companies located in a reconversion zone, as long as they benefit from the measures contained in the Act of 31 July 1984
- ✓ Investment companies
- ✓ Cooperative companies constituted in the context of workers participation
- ✓ Shipping companies applying the «tonnage tax»
- ✓ SMEs choosing to set up an investment reserve. These SMEs will not be allowed to apply the notional interest deduction for the taxable period during which they established an investment reserve, nor for the following 2 years.

## **How does it work?**

The principle is very simple. The amount that can be deducted from the taxable base equals the fictitious interest cost on the adjusted equity capital, or simply:

**Notional Interest Deduction = Notional interest rate x adjusted equity**

## Examples

(tax year 2013, i.e. accounting year ending on 31 December 2012 or later in 2013)

In the first example, the balance sheet of the Belgian entity shows that the share capital has been used for group financing. With the application of an intra-group interest rate of 4 %, the profit before taxes is 4.000. Before the introduction of the notional interest deduction, the corporate tax would have been 1.360 (or 33,99 %). Thanks to the notional interest deduction, the effective corporate tax to be paid is 340 (or 8,5 %) only.

Assets	Liabilities
Group Financing	Share capital
100.000	100.000

P & L account	Before notional interest deduction	With notional interest deduction
Profit before tax	4.000	4.000
Notional interest deduction (3 %)	/	- 3.000
Taxable	4.000	1.000
Corporate tax (33,99 %)	1.360	340
Effective tax rate	33,99 %	8,5 %



The second example illustrates the result obtained for another operational Belgian company in the production field or in any other business, this time using a different approach. As long as the net result (return on equity) is equal or lower than the notional interest rate, no corporate tax will have to be paid. The effective tax rate corresponding to different rates of return on equity can be found in the following summary table.

Assets	Liabilities
Business assets	Share capital
100.000	100.000

Net result (return on equity)	Effective tax rate
≤ 3 %	0 %
4 %	8,5 %
5 %	13,5 %
6 %	17 %

## The qualifying equity

(adjusted equity capital)

The calculation of the tax deduction will begin with the «equity capital», as stated in the company's opening balance sheet for the taxable period. According to Belgian accounting law, «equity capital» includes capital, share premiums, revaluation gains, reserves, carry-forward of profits or losses, and capital investment subsidies. This «equity capital» will be adjusted by eliminating a number of amounts to obtain the adjusted or qualifying equity. The latter will form the basis for the calculation of the deduction.

The following amounts are deducted:

- ✓ The fiscal net value of own shares held on the balance sheet
- ✓ The fiscal net value of financial fixed assets qualifying as «participations and other shares» (non-portfolio participations)
- ✓ The fiscal net value of shares issued by investment companies (income fulfilling the conditions for the Belgian participation exemption)
- ✓ The net equity assigned to foreign permanent establishments or real estate property or rights. This only concerns the establishments and real estate situated in a country with which Belgium has concluded a tax treaty
- ✓ The net book value of tangible fixed assets, if costs do not unreasonably exceed professional needs
- ✓ The book value of tangible fixed assets that are considered as an investment not acquired in order to produce a regular income
- ✓ The book value of real estate where its use is granted to directors, their spouses or children
- ✓ Tax-free revaluation gains and capital subsidies.



These adjustments are aimed at avoiding duplicate use and abuse, as examples show: dividends and capital gains derived from shares are normally already eligible for the participation exemption. Profits of a permanent establishment and real estate located in a country with which Belgium has concluded a tax treaty are tax-exempt in Belgium. Private assets, such as jewellery or art work, could artificially boost a company's equity.

Any change to one of the components of the qualifying equity during the taxable period is taken into account on a prorata basis. Changes, upwards or downwards, are recorded as of the first day of the calendar month following the month in which they took place.

## **The rate**

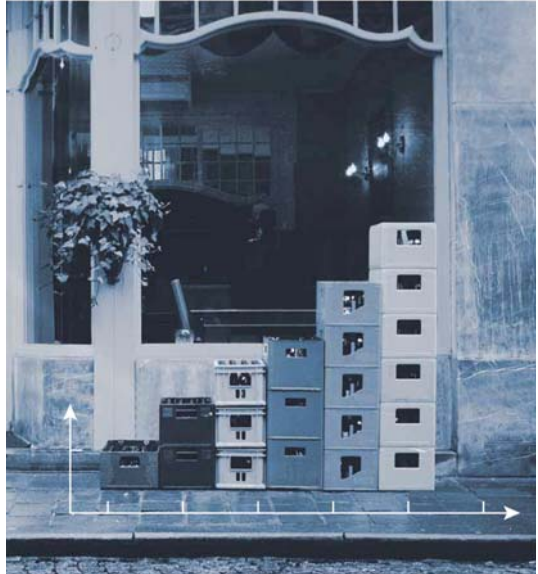
The notional interest rate for tax year 2013 (i.e. accounting year ending on 31 December 2012 or later in 2013) is 3 %. It has even been increased to 3,5 % for SMEs.

If the financial year of a company is shorter or longer than 12 months, the reference notional interest rate is multiplied by the number of days in this financial year and divided by 365.

SMEs are entitled to an upgrade of 0,5 %. A company qualifies as an SME if it meets the criteria mentioned in Article 15 of the Belgian Company Code.

## Special features

- ✓ If the company makes insufficient profit, the deduction can be carried forward to the following seven years
- ✓ The notional interest cannot be deducted from received abnormal or gratuitous benefits, and in case of a change of control of a company, the carry-forward privilege is only maintained when such a change can be justified for financial or economic reasons
- ✓ No acknowledgement is required for the notional interest deduction to apply, and the notional interest deduction regime does not preclude a company from performing a particular business activity
- ✓ No thin capitalisation provisions apply to qualifying equity
- ✓ No condition of investment in intangible or tangible assets, nor of blocking or freezing the amount on a separate account of the company's balance sheet applies
- ✓ No withholding tax on the notional interest deduction
- ✓ Dividends paid out of the amount of notional interest deduction normally qualify for EU Parent-Subsidiary directive and double tax treaties
- ✓ The only formal condition to comply with is the completion of an enclosure with the corporate tax return.



## CFC and home country regulations

For international companies, an essential aspect is to determine whether the home country, if it is outside Belgium, could annul or reduce the advantage of the notional interest deduction. The so-called «controlled foreign corporations» (or CFC) legislation of other countries, in particular, have to be taken into account. It is not the aim of this brochure to give an overview of such, sometimes complex, legislation that diverges greatly from one country to another. However, taking into account the many tax treaties Belgium has concluded, as well as EU law and EU fundamental freedoms, it has to be said that adverse consequences simply do not exist in many countries. For the few countries where they do exist, they can be avoided by using explicit exceptions or appropriate planning.

## Advantages

- ✓ The notional interest deduction is a valuable tool to maintain or even locate in Belgium activities which were previously allowed under the special tax regime of Belgian coordination centres
- ✓ It creates a considerable tax benefit for companies that have good solvency ratios, reducing the taxable base and generating a higher return after tax
- ✓ It provides flexibility, because it is possible to carry forward any unused amount of the deduction
- ✓ It is a permanent incentive and not just a one-shot advantage
- ✓ It strengthens the financial position of Belgian companies and branches by encouraging them to increase their equity
- ✓ It is an incentive to retain earnings in the Belgian entity and to use these to finance new investments

- ✓ For international groups, it opens possibilities for allocating new activities to a Belgian entity such as intra-group financing, central procurement or factoring.

The notional interest deduction combines with the extensive treaty network concluded by Belgium, the tax regime for expatriates, the access to European Directives and the Belgian ruling practice. This large set of measures makes Belgium an attractive location for capital-intensive companies, equityfunded headquarters and treasury centres.

# Contacts

For more information on other incentives and reasons to invest in Belgium, please visit [www.invest.belgium.be](http://www.invest.belgium.be) or contact the following federal and regional public bodies:

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