# Chapter 6: Belgium

## 1. Introduction

This article deals with tax transparency in the Belgian income tax system and the acquiring of income through hybrid entities. As such this concept of tax transparency has to be distinguished from other techniques ignoring the interaction of a tax subject and immediately taxing persons acting through such subject or simply not recognizing a certain taxable flow of income.[1]

Three different aspects will be treated.

The first part examines how Belgium attributes income to taxable subjects for its income tax legislation, more precisely the conditions for an intermediary entity to qualify under Belgian income tax law as a separately taxable (opaque) person. This can be defined as the classification of the entity, determining whether such entity is separately taxable or if income acquired through such entity will immediately be taxed at the level of the participating partners.

The second part describes how Belgium interprets its commitments under double tax treaties when its classification of an intermediary entity differs from the classification of this entity under the tax laws of its treaty partner.

Finally the third and last part analyses if and how a tax transparent classification can influence the Belgian implementation of the European tax directives, treated in Chapter 2 of this book.

## 2. The autonomous Belgian classification method

### 2.1 The legal approach

The Belgian tax law hardly provides for specific regulations concerning the classification of domestic or foreign entities. For the attribution of income to a tax payer, the tax law largely adheres to Belgian private law and taxes the person receiving income according to these common rules.[2]

This explains the importance attached to the concept of 'legal personality'.

A legal person is acknowledged as a subject capable of acting independently in judicial matters and in possession of a proper capital. It can autonomously acquire income and separately supports income taxes on this income. A further distribution of its profits to any participating partner constitutes an additional taxable event, separately taxable at the level of the participating partners.

On the other hand the assets and liabilities of an entity without legal personality are conceived as a joint ownership between the participating partners. Any received income is taxed immediately at the level of these partners, irrespective of their ability to autonomously dispose of the common assets.

This fixed approach, linked to the concept of legal personality, is implicitly integrated in the Belgian Income Tax Code 1992. (Hereafter ITC 1992)

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[1] E.g. the requirement to qualify as beneficial owner to be entitled to certain tax benefits or particular anti-abuse measures that immediately attribute income to shareholders abusing a certain intermediate company to acquire unintended tax benefits.

[2] For some particular exceptions, see P. LION, "Conflicts in the attribution of income to a person", *Tijdschrift voor fiscaal recht* 2008, 735-749.

### *2.1.1 Classification of domestic entities*

For separately taxable residents/domestic entities, the Code distinguishes between natural persons, companies and other legal persons.
A 'company' is further described as "*any corporation, association, institution or establishment, legally established and possessing legal personality, which carries on an enterprise or is engaged upon profitable transactions*".[3] Besides these companies, a separate income taxation has been provided for other legal persons, not engaged in a business activity. Civil companies or associations without legal personality are classified tax transparent. Any acquired income is qualified as taxable income at the level of the partners irrespective of its actual distribution to them.[4]

Some domestic entities, although having legal personality, are exceptionally classified tax transparent in the well-chosen words that for income tax purposes "*they are considered to be associations without legal personality*". Article 29, §2 ITC 1992 provides for a list of such specific Belgian[5] entities and is further completed with some particular regulations. Particular justifications exist, but differ for each separate mentioned entity.

### *2.1.2 Classification of foreign entities*

#### 2.1.2.1 General approach

The same fixed approach generally determines the classification of foreign entities for Belgian tax purposes. Non-resident/foreign tax payers earning Belgian income also qualify according to similar distinctive criteria. Art. 227 ITC 1992 distinguishes between natural persons, companies and (other) legal persons. Belgian partners participating in a foreign entity without legal personality will immediately be taxed on the income earned by the entity, whether or not this income is distributed to them.[6] For distributed income to be qualified as 'a dividend' it has to be paid by a company[7], which presupposes an entity with legal personality.[8]

Thus, as a starting point for the classification of a foreign entity, one needs to determine whether or not this entity has a legal personality. This has to be determined according to the applicable law as defined by Belgian international private law.[9]
Article 111 of the Belgian Code on international private law refers for this question to the *lex societatis* of an entity. This is further clarified as the law of the residence State of the head office of an entity, according to the so-called real seat-doctrine. However, if the international private law of this state refers to the law of incorporation the latter legal system has to be applied.[10]

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[3] Article 2, 5°, a) Income Tax Code 1992.
[4] Article 29, §1 and 364 Income Tax Code 1992.
[5] Besides European economic interest groupings, all the mentioned entities are Belgian legal forms.
[6] Article 29, §1 and 364 Income Tax Code 1992.
[7] Article 18, 1° Income Tax Code 1992.
[8] Article 2, 5°, a) Income Tax Code 1992.
[9] Cf. Ruling nr. 2013.49 (Because a Luxembourg fonds commun de placement has no legal personality, it is classified tax transparent in Belgium), nr. 2011.101 (a British limited partnership without legal personality is tax transparent for Belgian tax purposes), www.fisconet.fgov.be
[10] Article 110 Belgian Code on International Private Law.

This applicable law only determines whether the foreign entity is a legal person. The tax classification of this entity under its resident state's tax law does not matter. Based on the principle of the territorial scope of income tax law a principle of sovereignty concerning the classification of an entity has been deducted. For Belgian income taxes the Belgian tax classification applies irrespective of a foreign tax classification of an entity in its own residence state. As such in an early judgement of 1974, the Brussels Court of Appeal decided that the (French) income of a French Société civile immobilière (SCI) with Belgian partners cannot be taxed in Belgium as long as this income is not distributed by the entity to its partners. Because a French SCI is an entity with legal personality, it has to be classified opaque under Belgian income taxes. The French classification of this entity as 'translucide'[11], levying an income tax upon the partners for the income acquired by the SCI, is of no importance.[12]

There are no explicit legal regulations to determine what happens when a foreign legal system is not familiar with the concept of 'legal personality'. However it has been accepted in such case to compare the civil law characteristics of the entity with the characteristics Belgian civil law links to this concept. As such a Belgian tax court decided that a U.S. 'General Partnership', according to the corporate laws of the state of Michigan, cannot be considered equal to Belgian legal persons and therefore had to be classified tax transparent.[13]

#### 2.1.2.2 Extension in case of Belgian income

In inbound cases the Belgian income tax code provides for two particular extensions. As a first extension, the presence of a tax transparent entity (a head office as well as a mere permanent establishment) is immediately attributed to each partner in the entity. Besides a non-resident entity without legal personality that acquires Belgian income might be classified tax opaque, if it is founded in a legal form comparable to the form of a Belgian company that would have been separately taxed on its Belgian income.[14] Both extensions are commented further in the following paragraphs.

Once a transparent entity is considered to be established in Belgium, to have a permanent establishment in Belgium or to exercise an activity in Belgium, this conclusion applies for all individual partners participating in the entity, whether or not they are personally engaged in this Belgian activity.[15] This enlargement doesn't figure in most of Belgians double tax

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[11] Article 8 of the French Income Tax Code.

[12] Court of appeal of Brussels, 4 June 1974, *Journal de droit fiscal* 1975, 82. In a case analogous to base case 1 Belgian partners participated in a French SCI that earned French real estate income. Although the SCI had not yet distributed any income to the Belgian partners, the Belgian tax administration imposed income taxes on the Belgian shareholders for the income of the SCI, referring to the French tax classification. This taxation was rejected by the Court of appeal of Brussels.

[13] Court of appeal of Brussels, 30 April 1998, *Algemeen fiscaal tijdschrift* 1999, 119, note A. VAN DE VIJVER. The Court analyzed the Uniform partnership act, as applied in the state of Michigan, and considered that a general partnership has different accounts for each of its partners. Each partners capital contribution is treated separately, profits and losses of the partnership are immediately be taken into account in the separate partners accounts, while the partners are personally liable for the debts of the partnership. The partnership ends in case of the death, illness, bankruptcy or incapacity of one of its partners, while an individual partner cannot unilaterally withdraw from its participation. From this the Court concluded that an American general partnership had to be classified tax transparent for Belgian income tax purposes.

[14] Article 227, 2°, part 2 Income Tax Code 1992.

[15] Article 229, §3 Income tax code 1992.

conventions.[16] Although the Belgian legislator introduced it in the Belgian Model tax convention of 2007, it was again removed in the subsequent model convention of 2010.

Besides Belgium also provides for an extension in base case 2. Even if a foreign entity has no legal personality, according to its applicable *lex societatis*, it still might be classified separately taxable as a non-resident tax payer in Belgium. The legal text requires the entity to be comparable to a Belgian company. However, as no precise criteria are mentioned and the further consequences of this enlargement are not integrated in the Belgian income tax system, the exact scope and application of this regulation remains rather unclear.

The scope could be further elucidated by making reference to the introduction of this regulation. This rule replaced the earlier article 139, 2° Income tax Code 1964 under which every foreign entity was classified as separately taxable. The Belgian legislator feared difficulties for the Belgian tax administration to levy taxes on Belgian income derived by transparent foreign entities with foreign partners.[17] Always focusing on the entity itself would largely facilitate the role of the tax administrator..
However this automatic classification for income taxes distinguished between foreign entities and comparable Belgian entities without legal personality. As no convincing justifications could be provided, the Belgian legal doctrine doubted its conformity with Belgian double tax conventions and European law.[18] This distinction was challenged for the Brussels Court of Appeal by a Dutch maatschap. (a foreign entity without legal personality comparable to a Belgian maatschap, a tax transparent entity).[19] Nonetheless, not attending the final outcome of the case, the Belgian legislator replaced the unlimited separate liability to tax by a resemblance test. Although the preparatory documents of the bill made no reference to this specific case, the legal amendments were explained as to "*remove certain discriminatory measures*".[20]
Although the text of the regulation refers to the larger category of all Belgian companies (with and without legal personality), from this historic development it can be concluded that foreign entities are to be compared with the legal form of Belgian separately taxable companies.

Besides this historical origin, the application of this article still remains unclear. The comparability test is complicated, as no indications to determine the applicable foreign law aspects, nor criteria to fulfill are provided. Besides the extension does not take into account secondary effects of its integration into the Belgian income tax system.
As concerns the applicable law, Belgian international private law seems to leave this question to the parties concerned as a cooperation between partners in a legal form without legal personality still can be seen as a contract. Article 98, §1, part 1 of the Belgian Code on international private law refers to the convention of 19 June 1980 on the law applicable to contractual obligations, as replaced by Regulation (EC) No 593/2008 of the European

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[16] Exceptions are e.g. the double tax convention with France of 1964 (art. 4, §2 of the treaty leaves the exclusive power to tax the business income of a transparent entity to the resident state of the entity), as well as the convention with the US of 2006 (art. 3, 1, c of the treaty defines an enterprise of a Contracting State as also including an enterprise carried on through an entity that is treated as fiscally transparent in that Contracting State).
[17] Bill of 30 May 1973, Parliamentary documents Senate 1972-1973, nr. 278, p. 65.
[18] P. HINNEKENS, 'Belasting van niet-inwoners vennootschappen: fiscale transparantie van buitenlandse entiteiten" in W. MAECKELBERGH (Ed.), *Fiscaal praktijkboek 1992-1993. Directe belastingen*, 93-112. Italy however still maintains such opaque classification for all foreign entities. Cf. §10.2.2.2.
[19] Court of appeal of Brussels 3 November 1987, *Algemeen fiscaal tijdschrift* 1988, 189, note M. DASSESSE.
[20] Bill of 22 December 1989, Parliamentary documents Senate 1989-90, nr. 806/1, p. 82.

Parliament and of the council of 17 June 2008 on the law applicable to contractual obligations.[21] Although this convention and its subsequent regulation both exclude from their scope "*questions governed by the law of companies and other bodies, corporate or unincorporated ...*"[22], its scope is enlarged for Belgian international private law purposes in article 98,§1, part 2 Belgian Code on international private law. Therefore the cooperation between the partners will be governed by the law chosen by them.[23] In the absence of a choice the entity will be governed by the law of the country to which it is most closely connected.[24]

Once a legal system has been determined, the foreign entity will be separately taxable for Belgian tax law when it is established in a legal form "*comparable*" to the legal form of a Belgian (separately taxable) company. Further criteria to verify this comparability are however not provided. The most crucial aspect, legal personality, will by definition be lacking. In addition foreign legal entities might often have characteristics of both Belgian transparent and separately taxable entities[25], or will not have any Belgian equivalent at all.[26]

Finally it can be noticed that this extension has been integrated, without taking into account any further secondary effects at the level of the participating partners. (Belgian and foreign) partners participating in such foreign legal form with Belgian income will in theory also be separately taxable on the same income, because the income of an entity without legal personality is immediately attributed to its participating partners.[27] No legal priority is foreseen concerning this double fiscal attribution of the same taxable income.[28]

Under the earlier general extension the tax administration accepted (without any legal basis) a certain priority: the foreign entity was only taxed on income that could not be taxed at the level of the partners.[29] It remains however doubtful if this same approach can still be applied. As, with the introduction of article 229, §3 Income Tax Code, every partner in an entity without legal personality is considered to dispose of a Belgian permanent establishment, this administrative tolerance would render the extension of article 227, 2°, part 2 Income Tax Code meaningless.

### *2.1.3 Conformity with EU-law ?*

It remains disputable whether the actual Belgian classification is still discriminating.

Clearly some differences exist between the classification of domestic and non-resident entities, as well as between different non-resident entities. Three general differences can be noticed, because of the link to the concept of legal personality, as well as the non-acceptance of domestic exceptions towards foreign entities.

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[21] *OJ L* 4 July 2008, nr. 177, 6. This regulation applies to contracts concluded as of 17 December 2009.

[22] Article 2, e) of the convention and 2, f) of the Regulation.

[23] Article 3 Regulation 593/2008.

[24] Article 4 Regulation 593/2008.

[25] As such American general/limited partnerships have characteristics of Belgian partnerships with legal personality (especially a 'vennootschap onder firma' and a 'gewone commanditaire vennootschap') and characteristics of Belgian partnerships without legal personality (p.e. a 'stille handelsvennootschap'). Cf. A. PIERON, *L'impôt des non-résidents*, Brussels, Larcier 2005, 59-60.

[26] As such a very difficult legal form to classify is a trust.

[27] Article 29, §1 Income Tax Code 1992, which for foreign taxpayers has to be combined with article 227, 1° and 2 ° Income Tax Code 1992.

[28] Belgium also has an internal legal principle to avoid double taxation, but this principle is only meant as a barrier between different legislative levels. (E.g. a possible competence conflict between the federal and regional level, Cf. art. 1ter, 2° Finance law of 16 January 1989, or a conflict between municipalities and the federal level, Cf. Law of 23 January 1989).

[29] Circular Ci. RH.61/269.003 of 9 May 1974, *Bulletin der belastingen* 1974, nr. 520, 1365.

First of all the concept of 'legal personality' does not cover the same scope in each foreign country. Nonetheless the Belgian classification rules are linked to the use of this homonym, regardless of its actual content. Receiving 'legal personality' is sufficient for an opaque classification. As such it is illustrative to refer to an earlier development in the Dutch legislation regarding partnerships. A new legislation was proposed [30] to offer Dutch partnerships an option for legal personality. Although in a Dutch context this could be realized without tax consequences, the mere receiving of legal personality would make the new 'openbare vennootschappen met rechtspersoonlijkheid' separately taxable in Belgium. After many years of uncertainty and delay finally however this proposal was removed.
A second difference concerns Belgian exceptions to the opaque classification. Some domestic entities are classified tax transparent (or can opt for it), although having legal personality.[31] Except for the EEIG however, this exception is not applicable for foreign comparable entities, that will always be classified as opaque, when having legal personality.
Finally the classification of non-resident entities for Belgian tax purposes differs, when a foreign company law has no concept of legal personality. Only in this case foreign entities, receiving Belgian income, will be classified according to autonomous Belgian criteria.

As such the Belgian classification criteria for Belgian and foreign entities still differ. To our knowledge, this distinction has not yet been challenged before the European Court of Justice. The mere fact that Belgian income of a foreign entity would bear a more burdensome taxation compared to similar Belgian entities clearly constitutes an infringement on the freedom of establishment.[32] However, it remains less clear how the actual tax burden has to be compared. Income acquired through a tax transparent entity will be taxed according to a single tax approach, immediately levied at the level of the partners. Income acquired through a separately taxable entity will be taxed according to a double tax approach, a first tax at the time of gathering the income at the level of the entity, completed with a second taxation when the entity distributes the income to its partners.[33] Given the fact that tax advantages exist to mitigate the effect of a double tax level, both approaches could end in a comparable tax burden.

Interesting in this context is the judgement of the Court of Justice on 23 April 2009. [34]
Greece applied a different tax rate on Greek income for domestic and foreign partnerships, which was challenged by the European Commission. The Greek administration argued that this difference could be justified because half of the income of a domestic partnership was taxed at a higher tax rate at the level of the partners as remuneration. This additional taxation would neutralize the difference in tax burden between a domestic and a foreign partnership. However in its comparison the Greek administration calculated the tax burden on income of a domestic partnership by making reference to actually distributed income to the partners. This tax burden was compared with the initial taxation at the level of a foreign partnership.[35] Any further taxation when income of a foreign partnership would be distributed to its (eventually Greek) partners was not taken into account. In addition the tax administration only argued

[30] For many years a Bill was proposed introducing a new Chapter 7.13 in the Dutch Civil Code, recognizing this new entities as entities with an option to choose for legal personality. Cf. Kamerstukken II 2002/03, nr. 28746.
[31] Cf. art. 29, §2 ITC '92.
[32] Cf. Conclusion of Advocate-general Jacobs in Case C-312/93, Peterbroeck, Van Campenhout & Cie SCS vs. Belgium. Notice especially consideration 15 referring to Court of Justice 28 January 1986, C-270/83, Commission vs. France.
[33] Cf. J. BARENFELD, *Taxation of crossborder partnerships. Double tax relief in hybrid and reverse hybrid situations*, Amsterdam, IBFD Publications BV 2005, 93 ff.
[34] Court of Justice 23 April 2009, C-406/07, Commission vs. Hellenic Republic.
[35] Court of Justice 23 April 2009, C-406/07, consideration 33.

from a general and abstract point of view without further proving that the taxation of foreign and domestic partnerships would finally lead to a same tax burden.[36] Therefore the Court did not accept this justification.[37]
Nonetheless, if it could be proven by a tax administration that a difference in classification never leads to a higher (global) tax burden for income acquired through foreign entities, the mere difference in taxation at the level of the entity does not necessarily has to be considered contrary to the European freedoms. However in most cases it seems that such difference can have a negative effect hampering economic freedoms.

## 2.2 The practical approach

Belgian tax law, although providing for an autonomous classification system, keeps many uncertainties. Notwithstanding its focus on the concept of 'legal personality', it lacks of general characteristics to qualify as a legal person. This creates a lacuna in the classification system. When a foreign legal system does not use the concept of 'legal personality' or the legal form of a foreign entity without legal personality has to be compared with the legal form of Belgian separately taxable entities, taxpayers, the tax administration and eventually courts are left without further indications for the classification of such foreign entity.
Besides it can also be noticed that the tax administration remarkably deviates from the outlined legal 'abstract' approach in favor of a more substantive approach. Belgian tax law has a preliminary ruling system for tax payers wondering how planned activities will be treated from a tax perspective. Different rulings are provided concerning cooperation through one or another foreign legal entity needing to be classified for Belgian tax purposes. Although the substantive economic reasoning of the commission for anticipated decisions can be approved, it is sometimes hard to conciliate this practice with the legal context.
Both aspects are further illustrated below.

### *2.2.1 Characteristics of a 'legal person'*

Reference has already been made to a case before the Court of Appeal of Brussels of 30 April 1998.[38] The Court had to determine whether or not an American general partnership could be considered as a 'legal person' for Belgian tax purposes. The same question arose in some rulings, in which the tax administration in particular had to clarify the tax classification of foreign entities.[39] These latter rulings both concerned Belgian income and foreign income attributed to Belgian partners.

From these cases it can be deducted that, as a point of departure, the search for a common denominator for 'legal personality' in Belgian law usually starts with the concept of a 'separate capital'.[40]
However, this concept is almost as vague as the general concept of 'legal personality'.
This can be illustrated with the legal forms of a German 'Kommanditgesellschaft' or a U.S. 'General partnership'. Although these entities can have property apart from the goods of their

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[36] Court of Justice 23 April 2009, C-406/07, consideration 31.
[37] Court of Justice 23 April 2009, C-406/07, consideration 40.
[38] Court of appeal of Brussels, 30 April 1998, *Algemeen fiscaal tijdschrift* 1999, 119, note A. VAN DE VIJVER.
[39] Ruling nr. 2013.527, nr. 2011.515, nr. 300.326, nr. 500.190, nr. 500.198, nr. 500.232, nr. 600.164, nr. 600.398, www.fisconet.fgov.be.
[40] See for instance: A. BAX, "De Belgische belastingheffing van buitenlandse partnerships: een imbroglio", *Tijdschrift voor rechtspersoon en vennootschap* 2006, 35 en K. GEENS, "De fundamenten van het vennootschapsrecht dooreengeschud voor de eeuwwende" in X., *De nieuwe vennootschapswetten van 7 en 13 april 1995* Kalmthout, Biblo 1995, 24, with further references.

partners[41], they are still structured as a form of co-ownership and use a separate capital account for each partner.[42] This complicates a clear answer concerning the question for the separation of a capital.
In addition, separation of capital is not an exclusive quality of legal persons. Belgian civil law also recognizes other techniques to isolate a capital, such as a bankrupt estate or a marital community of goods.[43] Nevertheless, these legal concepts are not considered to create a separate legal person.
However, when a partnership agreement indicates how partners have to use their personal activa (as well as activa acquired within the partnership), this can also be an indication of the lack of a separate capital, denying the existence of a legal person.[44]

Confronted with these difficulties for their Belgian tax classification, foreign entities interrogated the Belgian administration concerning their tax treatment. In these preliminary rulings the administration looks for additional characteristics, such as how the partners register their participation in the entity, whether or not their liability for the debts of the partnership is limited[45], if they can freely transfer their participations, if the existence of the entity ends up by the retreat of one of the partners, which formalities have to be fulfilled for the founding of the entity and even sometimes[46] refers to the tax classification in the country of origin ...[47] However these rulings do not provide for well-defined criteria, but merely generally justify an applied classification. As such, the classification of an entity is based upon an evaluation of a group of indications, each of them individually however not being very convincing.

### *2.2.2 A different practical approach*

Notwithstanding the difficulties to provide for a clear-cut enumeration of the prerequisites to qualify as a 'legal person', the Belgian tax administration in its recent rulings sometimes deviates from the described legal approach and also applies the resemblance method for classifying foreign entities, irrespective of the clear answer given by the applicable foreign law system. Even though an applicable foreign law system is familiar with a concept of 'legal personality' and clearly attributes or denies this to a certain entity, the administration still examines its particular characteristics to classify the entity for Belgian tax law purposes.

This approach had also been used by a Belgian commission established for providing non-compulsory advice concerning accounting principles. The Commission was asked how

[41] A German Kommanditgesellschaft can "*Eigentum und andere dingliche Rechte an Grundstücken erwerben*" (Cf. §161, part 2 *jc.* §124 of the German Handelsgesetzbuch) and the American Uniform Partnership Act confirms that "*property acquired by a partnership is property of the partnership and not of the partners individually*" (Section 203).

[42] As such the profits and losses of a German Kommanditgesellschaft are immediately attributed to the different capital accounts of each partner (§120 and 121 Handelsgeseztbuch), while the Uniform Partnership Act applies a so-called 'aggregate approach', meaning that the consequences of acts of the partnership are immediately born by the individual partners.

[43] A. DE WILDE, *Boedelschulden in het insolventierecht*, Antwerpen, Intersentia 2005, 6.

[44] Cf. The exempted limited partnership law and the partnership law of the Cayman Islands oblige partners of an exempted limited partnership to use their contributed resources exclusively for the purposes of the partnership. This explicit obligation was considered to be an indication of the lack of a separate legal personality. Ruling nr. 2013.527 of December 10, 2013, www.fisconet.fgov.be.

[45] E.g. ruling nr 2011.276 of October 18, 2011, www.fisconet.fgov.be. (A US LLP in the State Illinois considered to be an entity with legal personality for Belgian tax law).

[46] Ruling nr. 2013.501 of December 3, 2013, www.fisconet.fgov.be Although given the Belgian tax sovereignty this reference cannot be approved.

[47] For an extensive decision, cf. e.g. Ruling nr. 2011.276, www.fisconet.fgov.be

Belgian companies had to register their participations in German 'Kommanditgesellschaften' and Dutch 'commanditaire vennootschappen'.[48] Although both entities clearly lack legal personality they strongly resemble the legal form of a Belgian gewone commanditaire vennootschap, a legal form with legal personality. Therefore the Commission concluded that the participations had to be registered as shares in another company. Proceeding this way, the Commission immediately referred to the Belgian law, the *lex fori*, without taking notice of the clear answers according to the German and Dutch law system, as applicable *legi societatis*. The Belgian legal doctrine was rather critical about this advice.[49]
Despite the doctrinal criticism, the tax administration proceeded this approach in many recent rulings, concerning the classification of German Kommanditgesellschaften[50], an exempted limited partnership of the Cayman Islands[51], a limited partnership of the Bermudas[52], … Although, according to the *lex societatis*, these entities clearly lack legal personality, the tax administration still compared them with their most equivalent Belgian legal form, even though the questioned applications did not consider the extension of article 227, 2° Belgian Income tax Code.[53]

Some remarkable decisions concerning a U.K. 'Limited Liability Partnership' merit particular attention.[54] The tax administration was asked about the Belgian tax treatment of Belgian and foreign income acquired through such a partnership with Belgian and foreign partners.[55]
Although being a separate legal person[56], for U.K. tax law this entity is classified tax transparent.[57] In theory however, for Belgian income tax law purposes only the attribution of legal personality matters. The UK tax treatment has no influence for Belgian income taxes.
Nevertheless the Belgian tax administration deviates from this basic principle and attributes parts of the income acquired by the LLP directly to the participating partners.
The administration distinguishes the tax treatment of the Belgian partners (or foreign partners with an autonomous permanent establishment in Belgium) from the tax treatment of foreign partners. As far as Belgian partners are concerned, the UK LLP will be treated tax transparent: Belgian partners are immediately taxed on their proportionate part in the profits of the partnership, without awaiting any distribution of the profits from the partnership to the partners; foreign losses of the LLP can be deducted from the partners' taxable income; the taxable income always qualifies as a profit of the partner (instead of a dividend) without making any difference between a remuneration of the Belgian partners for their activities in Belgium and their proportionate part in the profits of the partnership; foreign income of the

[48] Advice CBN 168/1, *Bull. C.B.N.* 1993, nr. 30, 31.
[49] T. WUSTENBERGHS, *Heffingsbevoegdheid bij grensoverschrijdende ondernemingswinsten. De vaste inrichting op de helling*, Larcier, Gent 2005, 583 with further references.
[50] Ruling nr. 500.190, 600.534, www.fisconet.fgov.be.
[51] Rulings nr. 2013.527, nr. 600.164, nr. 700.215, www.fisconet.fgov.be.
[52] Ruling nr.600.465, www.fisconet.fgov.be.
[53] A different approach was taken in ruling nr. 2011.515 of February 28, 2012. The administration stressed upon the lack of legal personality of an English Limited partnership, but added as a supplementary comment an analysis according to the Belgian characteristics of legal personality.
[54] This legal form was introduced by the Limited Liability Partnerships Act of 20 July 2000, in force on 6 April 2001.
[55] Rulings nr. 2013.575, nr. 2013.110, nr. 2011.239, nr. 2010.229, nr. 300.230, nr. 400.233, nr. 400.373, nr. 500.003, nr. 500.004, 500.076, nr. 500.199, nr. 500.210, nr. 500.252, nr. 700.484, nr. 800.249, nr. 900.260, nr. 900.421, www.fisconet.fgov.be.
[56] According to article 1, part 2 of the Act "*a limited liability partnership is a body corporate (with legal personality separate from that of its members) which is formed by being incorporated under this Act*".
[57] Article 10 of the Act: "*For the purposes of the Tax acts, a trade, profession or business carried on by a limited liability partnership with a view to profits shall be treated as carried on in partnership by its members (and not by the limited liability partnership as such); and, accordingly, the property of the limited liability partnership shall be treated for those purposes as partnership property*".

partnership is exempted based on the double tax convention between Belgium and the source country of the income, …
As far as foreign partners are concerned, the Belgian tax administration taxes the partnership itself on the part of the Belgian profits attributable to them.
In these decisions, the administration not only deviates from the Belgian legal approach, but also introduces a kind of partial transparency (for the income of Belgian partners). This reasoning is based on the fact that in the UK an LLP is tax transparent and therefore does not apply for tax treaty limits of the UK's double tax conventions. According to the tax administration this lack to treaty entitlement justifies the application of the respective treaties concluded by the residence states of the respective partners.
As the approach of the Belgian Commission for accounting principles was criticized, also the legal validity of these latter rulings can at least be doubted.

### 2.3. Conclusion

Although Belgian sovereignty is accentuated, Belgian tax law does not provide for an exhaustive methodology for the classification of foreign entities. In principle the classification of an entity refers to private law and the attribution of income for income tax purposes is based on private law principles.
Therefore it has to be decided whether or not an entity qualifies as a legal person according to its applicable private law. However, the criterion of 'legal personality' lacks substantive characteristics. If a foreign law system does not give a clear answer, or an entity without legal personality acquires Belgian income, a further substantive comparison has to be made to decide whether or not this entity resembles to a Belgian legal person. In these cases the lack of substantive characteristics becomes apparent and leads to a practical evaluation of different criteria. Despite this lack of clear substantive indications, the Belgian tax administration often deviates from this legal approach and immediately verifies whether or not a foreign entity resembles a Belgian entity to classify the foreign entity accordingly.

## 3. Implementation of the OECD approach in Belgium

### 3.1 General importance of the OECD Model and commentary in Belgium

Belgium has a monistic legal system.[58] Once accepted by Belgian parliament[59], provisions of a treaty that are self-sufficient immediately apply in the Belgian legal system, without having to be converted into national legislation. Regulations concluded in a treaty further have priority over internal legal provisions.[60] Therefore the engagements taken in double tax conventions have priority over domestic tax regulations, without being explicitly integrated in the Belgian (internal) Income Tax Code.

[58] M. BOSSUYT en J. WOUTERS, *Grondlijnen van internationaal recht*, Antwerpen, Intersentia 2005, 148 ff.
[59] Despite the immediate application of a treaty, article 167, §2 Belgian Constitution requires a formal law by which the parliament approves the concluded treaty. In principle the text of a concluded treaty has to be published in the Belgian law gazette together with the approval law.
[60] Although this primacy was accepted by the Belgian Supreme Court (Cass. 27 May 1971, *Pasicresie* 1971, I, 886) and the Belgian Administrative Court (Raad van State nr. 62.922, 5 November 1996, *Pasicresie* 1996, IV, 119), the Belgian Constitutional Court considers itself competent to examine the formal law of approval for compatibility with the Belgian constitution. (Arbitragehof 16 oktober 1991, nr. 26/91, www.const-court.be). Not only when approving a treaty, but also in a later lawsuit this could still render the provisions of a treaty inoperative because of its incompatibility with the Belgian Constitution.

From a strict point of view however, the only legal source for Belgian tax law purposes are concluded double tax conventions. The OECD Model and its commentaries are not a treaty and therefore as such not legally binding.[61] Besides it can also be mentioned that, as from 2007, the Belgian tax administration developed a Belgian Model convention, renewed in 2010, to use as a starting point in treaty negotiations for new treaties or treaty amendments.[62]
Nevertheless both Belgian model conventions, as well as concluded conventions are based on the OECD Model. In some recent conventions Belgium even explicitly refers to the OECD Model or even the OECD Commentary.[63] Finally also the Belgian tax administration' compliance with the OECD sources evolved.[64] Therefore it can be concluded that also Belgium largely adheres to the OECD commentary.

## 3.2 Implementation of the OECD approach to hybrid entities

The OECD approach to hybrid entities has been explained in the so-called 'Partnership Report' as accepted by the Council in 1999[65] and implemented in the OECD Commentary in 2000. The approach can be summarized into two basic lines of reasoning, focusing on an obligation of on the one side the source state of the income and on the other side the residence state of the partners participating in a (reverse) hybrid entity.
The source state of income has to accept the eligibility to invoke treaty benefits as accorded by the residence state of a (resident) taxpayer. This can be the state of the partnership (in case of an opaque classification), as well as the state of the participating partners (in case this state classifies the partnership as tax transparent).
The residence state of the partners participating in a foreign entity may classify such entity according to its domestic tax principles. However, when applying a tax convention, this state has to accept the treaty application of the resident state of the entity as being in accordance with the provisions of the concluded tax convention, even if this classification differs from its own classification. It should provide for relief in case of double taxation, and does not has to exempt any longer when the resident state of the entity does not impose the income of the partnership because it immediately attributes this income to the partners.
Both aspects will be further clarified and illustrated with the Belgian point of view.

### *3.2.1. Belgium as a source state: accepting treaty entitlements according to the classification of a residence state*

§5 OECD commentary to article 1 confirms a priority principle to determine treaty entitlements. If a state attributes foreign income to one of its residents the source state of the income has to accept this attribution of income. Even if, according to its own classification,

[61] §29 Introduction to the OECD Commentaries. Cf. O. BERTIN, "Tax treaty interpretation in Belgium" in M. LANG, *Tax treaty interpretation*, Kluwer Law International 2001, 41-62; B. PEETERS, *Fiscale transparantie: toerekening van inkomsten*, Gent, Larcier 2011, 433 with further references in note 1724.
[62] The text of this draft can be consulted at http://fiscus.fgov.be/interfafznl/nl/international/conventions/modStand.htm.
[63] The Belgian Model convention of 2010 explicitly refers to it in §1 of the Protocol for the interpretation of treaty terms.
[64] A clear evolution can be noticed. Answering a parliamentary question in 1971 the Belgian Minister of Finance minimized the value of these sources as a document which is "*gewis nuttig, maar waaraan geen absolute waarde moet worden gehecht*" (for sure useful, but without any absolute value) Cf. Parliamentary question Nr. 207 of 24 September 1971, *Bulletin der belastingen* 1971, nr. 491, p. 2184. However in later legal proceedings (e.g. Cass. 28 May 2004, *Pasicresie* 2004, I, 940), as well as rulings (e.g. Ruling nr. nr. 700.484, www.fisconet.fgov.be) The tax administration invoked the OECD commentary as the leading guidelines for the interpretation of tax conventions. This reference finally was also explicitly repeated in a more general administrative circular. (Cf. Circular nr. 4/2010 of 6 April 2010, www.fisconet.fgov.be).
[65] OECD, *Issues in international taxation. N. 6: The application of the OECD Model Tax Convention to Partnerships*, Paris, OECD 1999, 129 p.

income is not attributed to a resident of the other state, the source state still needs to limit its taxation according to the provisions of the concluded treaty. This can as well be a treaty concluded with the resident state of the (hybrid) entity, as a treaty concluded with the resident state of participating partners in the entity. The autonomous classification of the foreign entity by the source state of the income is irrelevant.[66] Once the treaty entitlement is determined, the ultimate taxation however still will be levied according to the domestic classification of the entity by the source state. This principle is disbanded when the source state is at the same time a resident state (of the entity or the partners) and attributes the income to its own resident.[67] In such case it can again tax the income according to its own classification.
While the partnership-report did not consider it necessary to provide for a particular clause in the Model treaty, in the recent BEPS action 2, it is suggested to explicitly add this point of view in art. 1, §2 of the Model convention.

Historically, before the conclusion of the partnership-report, Belgium, as did most states, adhered to its own domestic classification criteria to determine applicable double tax conventions. Belgian taxable income was attributed to a tax payer according to Belgians domestic classification rules. Subsequently it was only verified whether this indicated tax payer could invoke benefits of a tax treaty.
A further specification can be made for income acquired by foreign entities, as well as for income acquired by tax transparent Belgian entities.
As already mentioned, under the earlier article 139, 2° Income Tax Code 1964 non-resident entities earning Belgian income were always classified opaque and separately taxed on their Belgian income. The Belgian administration only verified possible treaties concluded with the resident state of this foreign entity. Even if a (third) foreign state classified this entity tax transparent and attributed the Belgian income to its residents (partners participating in the entity), this treaty was not applied. In the beginning also the classification of the (resident) state of the entity did not matter. Even if the entity was not separately taxed in its resident state, the Belgian attribution of income to the entity satisfied for the application of the double tax convention.[68] However a later general commentary stated as an additional condition that also the residence state of the entity had to classify the entity as separately taxable.[69]
In case of Belgian income earned through Belgian tax transparent entities, the tax administration accepted to apply the double tax convention concluded between Belgium and the residence state of the partners if these partners were “resident persons” of the other state. Even when this (partner) state classified the Belgian entity opaque (and consequently did not tax the partners on the Belgian income), the Belgian administration, when taxing these partners according to the Belgian classification, still respected the limits of the double tax convention concluded with this state.[70]

[66] §§6.2 and 6.3 OECD Commentary to article 1 and §8.7 OECD Commentary to article 4 explicitly confirm that a treaty application does not depend on the classification of an entity and subsequent attribution of income by the state of source of the income.
[67] §6.1 OECD Commentary to article 1 confirms the right for the source state of income to impose its own residents when it classifies a foreign entity fiscally transparent. Irrespective of the classification of the entity in its own residence state, the income acquired in the source state can be taxed at the level of the resident partners without any treaty limitation.
§6.3 and 6.4 OECD Commentary to article 1 rely on the same reasoning when an entity is established in the source state but has foreign partners. Regardless of the classification of the entity by the state of the partners, the source state of income can tax the resident entity on the acquired income without any treaty limitations.
[68] Cf. Circular nr. Ci.RH.61/269.003 of 9 May 1974, *Bulletin der belastingen* 1974, nr. 520, p. 1365. See especially margin number 11 of the Circular.
[69] Belgian commentary on double tax conventions, nr. 3/24.
[70] Belgian commentary on double tax conventions, nrs. 3/27 and 4/114.

When amending article 139, 2° Income Tax Code 1964 also foreign entities could possibly be classified tax transparent. Therefore the Belgian Minister of Finance accepted to verify the application of the treaty concluded with the resident state of the participating partners when Belgian income was earned via a foreign tax transparent entity.[71] This point of view was subsequently confirmed by the tax administration.[72]

The approach of the partnership report concerning a source state was explicitly integrated in the Belgian convention concluded with the U.S.[73] and subsequently also in the Belgian Model Convention of 2007.[74] Both clauses are very similar to the first sentence of the newly proposed §2 in art. 1 of BEPS action point 2, but don't mention that this income attribution is exclusive.[75] Therefore, some authors in the legal doctrine considered this paragraph as an extension of the historical point of view to verify treaty entitlement from the point of view of a source state.[76] However it seems more likely to interpret this paragraph as an exclusive attribution of treaty benefits. Only when a residence state attributes income to one of its residents entitled to invoke the benefits of a treaty, the source state of the income has to respect the restrictions of the treaty, irrespective of its own attribution of income. On the other hand if the source state attributes income to a foreign tax payer, but this attribution is not followed by the residence state of the tax payer, the treaty limits between both states do not apply. In other words, the attribution of income according to the classification rules of the state of source does not meet the prerequisites for the application of a treaty.[77]
When Belgium renewed its Model in 2010, this additional paragraph has been deleted, supposing that this point of view is implicitly in the convention. This implicit reading could be derived from art. 27, §1 of the Belgian Model. This provision explicitly focuses on the distributive tax rules for interests, dividends and royalties. When this income is attributed to an entity being classified tax transparent in its resident state, the convention still applies (and the entity is regarded as beneficial owner), if the partners in the (tax transparent) partnership are taxed themselves in this state on their share in the partnership's income.
Although the precise scope of this provision is unclear, at least it can be noticed that the treaty application is also determined according to the taxation of the income in the state of residence of the entity. The attribution and taxation of the income in the source state remains unimportant. However, it can be regretted that this explicit point of view has been removed, compared to the earlier Model of 2007, as well as the new philosophy for the OECD Model.

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[71] Parliamentary question nr. 78 of 20 December 1990, *Vragen en antwoorden* Senaat 4 juni 1991, nr. 34, 1442.
[72] Commentaar W.I.B. '92, nr. 227/35.
[73] Art. 1, §6 Convention with the US. As this approach only determines treaty entitlement, the further taxation however will be in accordance with the domestic tax laws of the source state. Therefore art. 4 of the Belgian law of June 3, 2007, approving the double tax convention with the US, expressly provides how domestic tax law will be brought in accordance with the treaty, in case Belgium as a source state treats a foreign entity with American partners opaque, while from an American point of view the entity is qualified tax transparent. Belgian taxes will still be levied at the level of the entity. However, for the part of the income that is, according to the American attribution, regarded as income of the American partners, the treaty limits will be applied at the level of the entity. Cf. e.g. Ruling nr. 2011.276 of October 18, 2011.
[74] Art. 1, §2 of the Belgian Model convention of 2007.
[75] Both conventions mention treaty entitlement "*to the extent that income is treated as income of a resident*", while the new OECD proposal explicitly adds the words "*but only*".
[76] See for instance A. BAX, "Goedkeuring van de overeenkomst tussen België en de Verenigde Staten", *Fiscoloog internationaal* 2007, nr. 281, 2-3.
[77] This exclusive approach has been explained in the American commentary to the Belgian-US treaty. Cf. Technical explanation of the Convention, http://www.ustreas.gov/offices/tax-policy/treaties.shtml, 5-6. The same question arose under the Convention between the Netherlands and the US, under which the Dutch Staatssecretaris accepted this exclusive approach. Cf. Besluit Hybride entiteiten van 6 juli 2005, nr. IFZ2005/546M.

Besides these legal developments, the administrative practice shows having accepted the OECD point of view. This can a.o. be illustrated with the already mentioned different rulings about the UK LLP.[78] In these rulings the administration is also interrogated about the tax treatment of Belgian income attributed to other foreign partners of the UK LLP. Although under domestic tax law the UK LLP will be taxed, the administration still accepts to verify all the treaties with the resident states of the partners in the entity.[79]

### *3.2.2 Treaty application in Belgium as residence state of partners participating in a hybrid entity*

In a classification conflict between a resident state of an entity and the resident state of its partners none of both classifications prevails. Each state is allowed to apply the convention according to its own classification of the entity. The resident state of the partners however, has to accept the treaty application by the resident state of an entity according to its autonomous classification as a treaty application "*in accordance with the provisions of the treaty*".

This implies that in case of a hybrid entity separately taxed in its resident state, the resident state of the partners has to provide for double tax relief, even though according to the national classification rules of this latter state the income would immediately be attributed to the participating partners.[80] A subsequent taxation upon the distribution of the income by the entity to the partners will only be recognized as a separate taxable fact in the residence state of the entity. As the resident state of the partners does not tax this distribution, this state will not have to provide for any relief, even when this distribution (and its taxation) takes place before the actual taxation of the income at the level of the partners as a result of the initial acquisition.[81]

On the other hand in case of a reverse hybrid entity, the resident state of the entity classifies it fiscally transparent, immediately attributes the income to the partners and therefore does not tax the income. Although the resident state of the partners would attribute the income to the entity, it no longer has to provide for relief, as the income cannot be taxed in the other state according to the other states' treaty interpretation.[82]

The recent BEPS action 2 recognizes that, especially in case of reverse hybrid entities, taxation will in large depend on domestic tax law. Therefore domestic tax law has to be adapted to integrate taxable income at the level of an investor in case of an investment in a foreign reverse hybrid entity leading to a double non-taxation. It is recognized that the solution, as provided for in the partnership-report, does not cover all kinds of disproportionate taxation. The incompleteness of the partnership report was also reflected in Belgian practice, accepting the general given guidelines of the partnership report.

A first administrative Circular worth being mentioned was a Circular of 16 January 2004.[83]

In general terms the administration accepted that in case a treaty refers to national law for the interpretation of treaty terms a foreign source state of income can apply its own domestic tax law. If according to its qualification of the income the source state considers itself competent

[78] See footnote 54.

[79] However, as the activity of the entity is attributed to al partners, under each convention the partner is supposed to have a permanent establishment in Belgium so that Belgium can still tax all the income, acquired in Belgium. (As explained this taxation is levied according to domestic tax law at the level of the entity.)

[80] §32.3 and 32.4 and 69.2 OECD Commentary to article 23.

[81] §69.3 OECD Commentary to article 23.

[82] §32.6 and 32.7 OECD Commentary to article 23.

[83] Circular nr. AFZ/2004/0053 (AFZ 5/2004) of 16 January 2004, *Bulletin der belastingen* 2004, nr. 846, p. 856-894.

to tax a Belgian resident, Belgium would provide for double tax relief, even though under a Belgian interpretation of the tax convention the source state would not be allowed to tax this income. If the foreign source state considers Belgium exclusively competent to tax, Belgium would not apply an exemption, irrespective of its own treaty interpretation.
However, the treaty method to provide for relief in case of a potential double taxation would be in accordance with the Belgian classification of the income.
The Circular illustrated this with an example of a capital gain of a Belgian partner in an Austrian partnership with legal personality. For Austrian tax purposes the partnership was classified tax transparent, while for Belgian tax purposes (because of its legal personality) the partnership was opaque. From an Austrian point of view the capital gain qualifies as gains from the alienation of business property of an Austrian permanent establishment, taxable in Austria. From a Belgian point of view however the income would be considered a capital gain on shares in a legal person, exclusively taxable in Belgium.
The conflict was solved because Belgium would accept the Austrian taxation and provide for relief by exempting the Austrian income. The method to provide this relief under the treaty would however be determined according to the Belgian qualification. Under internal Belgian law capital gains on shares are exempted[84] and therefore the income of the Belgian partners would be exempted.
The reference to the Belgian qualification to determine the method for providing relief was at least doubtful. Only because of an internal exemption of the income double taxation could be avoided. In case the acquired income would be taxable under Belgian national law it was not clear how double tax relief would be provided for. Nevertheless, it took until 2010 before the Belgian administration accepted in a general Circular[85] to also concur with the qualification of income of a foreign source state to determine the method how to provide for double tax relief.

The Belgian Model Conventions of 2007 and 2010 also integrated a particular clause for reverse hybrid entities.[86] Income regarded as dividends from a Belgian point of view, derived from a foreign (reverse hybrid) entity will not be taxed as such in this foreign state. Because the entity in its resident state is classified tax transparent, the foreign state will immediately tax the partner (shareholder from a Belgian perspective), when the income is acquired by the entity. The following distribution of income will not be taxed as such. However, the general treaty clause for relief requires income to be taxed in the foreign state.[87] This particular treaty clause enlarges the Belgian exemption to cases whereby the distributed income is not taxed as such, but the receiving partner is directly taxed on the income, when the entity itself received this income.

As mentioned, the solutions provided for in the partnership-report for the conflict between two residence states are less clear and incomplete. This was also reflected in Belgian practice.
A particular question concerns Belgian partners/investors participating in a French Société civile immobilière (SCI), receiving French real estate income. A French SCI is a legal person[88], but classified 'translucide' under French income tax law.[89] From a French tax law perspective, the taxable income, as well as the final tax due, are calculated at the level of the

[84] Article 192 Belgian Income tax code.
[85] Circular nr. AFZ nr. 4/2010, addendum to Circular nr. Ci.R9.DIV/577.956 of 11 May 2006, www.fisconet.fgov.be.
[86] Art. 22, 2, b) of both Model Conventions.
[87] Art. 22, 2, a) Model Convention. A similar subject to tax-condition is applied for a domestic exemption of dividends received by a company.
[88] Article 1842 Code civil.
[89] Article 8, 2, 1° Code général des impôts.

entity, but subsequently claimed at the level of the partners according to their applicable income tax regime (natural person or company). The subsequent distribution of income from the SCI to its partners is not submitted to any further French income tax.
From a Belgian tax law perspective however, because of its legal personality, a French SCI should be classified as a separately taxable entity. The Belgian domestic income tax legislation qualifies the distribution of income from an SCI to its partners as a taxable distribution of a dividend.[90]
The double tax convention between France and Belgium dates from 1964 and does not contain the particular treaty clauses mentioned in the preceding paragraph. Nonetheless, the Belgian Supreme Court decided that the income, distributed by a French SCI to its Belgian investors, had to be exempted from tax in Belgium. [91]
Although not being confronted in this case with a clear reverse hybrid entity, the French 'translucidité' contains a certain similarity. However, the implications of this judgment may not be overestimated. The argument for the Supreme Court to exempt the income in Belgium was not based on the reasoning of the Partnership-report, but derived from the conventional treatment of income from immovable property. In line with art. 6 of the OECD Model Convention, art. 3.2 of the Belgian-French convention specifically allows the state where the property is situated to define 'immovable property'. The Belgian Supreme Court decided that, because according to French tax law the income of the Belgian partners qualified as real estate income, Belgium could no longer tax this income. Article 3 of the double tax convention between Belgium and France assigns France the exclusive right to tax income from immovable property situated in France. Therefore, as stipulated in article 19.A.2. of the convention, the Supreme Court decided that Belgium should exempt this income from taxation.
Therefore, although interesting, this judgment cannot be considered to represent the general treaty approach in cases of income acquired through a (reverse) hybrid entity. It can also be noticed that the outcome of this case provoked a legal dispute, as the Belgian tax administration would not accept this result.[92] The subsequent Belgian case law is still not univocal.[93]

A rather straight application can be found in an administrative ruling of November 2013.[94]
This case concerns the income Belgian investors receive from their investment in German immovable property through a Luxembourg 'Fond d'investissement spécialisé'.
From a Belgian (and Luxembourg) tax law perspective the Fund classifies as tax transparent. After further analysis, the administration concludes that the income from investments in Germany must be qualified as interest income, taxable at the level of the partners. According to this qualification, the double tax convention between Germany and Belgium also admits that this income can be taxed in Belgium.

[90] Article 18 Belgian income tax code.
[91] Supreme court 2 December 2004, www.cass.be
[92] The Belgian Minister of Finance distinguished between the acquisition of the income at the level of the SCI, only taxable in France, and the subsequent distribution of the income to the partners, which would still be taxable in Belgium. Cf. Parliamentary questions of 23 February 2005 and 11 January 2006, *Vragen en antwoorden* Kamer 2004-2005, 11959 en 2005-2006, 20183.
[93] The Court of Appeal of Liege, to which the case was referred, concluded that Belgium should exempt the income. Cf. Court of appeal of Liege 17 February 2010, *Tijdschrift voor fiscaal recht* 2010, 619, note C. DOCCLO. This reasoning was followed by the Courts of First Instance of Brussels (November 20, 2009), Bruges (January 7, 2013) and Mons (April 11, 2013). However, the Courts of First Instance of Brussels (February 11, 2010) and Bruges (April 17, 2012) followed the tax administration and decided the contrary.
[94] Ruling nr. 2013.454 of November 26, 2013, www.fisconet.fgov.be.

However, from a German tax law perspective, the Fund is classified separately taxable and its income is qualified as immovable property income, taxable in Germany according to the convention. Explicitly referring to the already mentioned Circular of 2004, the Belgian tax administration therefore accepts to exempt this income in Belgium, based on the interpretation conflict between Belgium and Germany.

A more remarkable decision is a ruling of October 2011.[95] Amongst other aspects the administration was also asked to pronounce about American income Belgian partners earned from a US LLP. The administration considered that although this partnership was tax transparent according to US Tax law, it classified as opaque for Belgian tax purposes. After analyzing the corporate characteristics of the LLP, the administration concluded it had to be treated as a separate legal person. As such it qualified as a reverse hybrid entity.

The administration explicitly referred to the OECD Partnership-report, as well as the Belgian Circular of 2004. As the income was taxed under American law at the level of the Belgian partners, Belgium being the resident state of the partners should provide for relief. The administration further concluded that (because of their participation in the LLP ?) the Belgian partners had a permanent establishment in the US and therefore this income could be exempt from tax in Belgium.

This point of view cannot be approved.

First of all the administration mixed up the acquiring of income (at the level of a separate legal entity) and its subsequent distribution to the partners. In the case at stake however, both aspects were immediately linked. Because of a particular agreement with another partnership, the reverse entity at stake would only receive this income, when its own resources would not satisfy to pay the partners the profits they were entitled to. The received resources therefore had to be used for paying the partners. Nonetheless a legal distinction still exists between the receiving of the income (taxed in the VS at the level of the partners) and the distribution from the partnership (normally taxed in Belgium at the level of the partners).

A second remark considers the qualification of a permanent establishment in the VS to give the Belgian partners relief for this income. If the Belgian partners had a PE in the VS (according to the Belgian point of view) there would be no need to solve the reverse hybrid conflict, as it did not lead to double taxation. It is only because, according to the different treaty application of both states, both states consider themselves competent to tax a conflict raises, for which the partnership report was looking for a solution. In its decision the tax administration first acknowledges the conflict and subsequently decides (without further motivation) that no conflict exists. This point of view is contradictory.

Finally the double tax convention contains a particular clause for reverse hybrid entities (art. 22, 1, b), similar as the already mentioned art. 22, 2, b) of the Belgian Model conventions. A dividend received from a reverse hybrid entity will not be taxed in Belgium, if the Belgian partner has already been taxed as such on his share of the income when the entity acquired this income. This clause was not applied for in the ruling. Most probably, the parties, as well as the administration did not invoke this clause, because in the same ruling Belgian income of the partnership, (also being redistributed to the partners), had already been qualified as business income instead of dividends. It would be a paradox if the same category of income, received from the VS, qualified as a dividend under Belgian tax purposes.

[95] Ruling nr. 2011.276 of October 18, 2011, www.fisconet.fgov.be. See also K. De HAEN, "Overdracht van een Belgische inrichting door UK LLP aan US LLP: Belgische fiscale behandeling", *Internationale fiscale actualiteit* 2012, nr. 7, 1-5.

## 3.3 Conclusion

The Belgian treaty approach to hybrid entities has evolved since the outcoming of the partnership-report. Belgian laws, treaties, as well as administrative practice seem to adhere to the OECD points of view. However, as the recent BEPS actions illustrate, not all conflicts already have a clear solution. The precise treaty application and motivation to solve conflicts still raises some doubts. Therefore, in its recent double tax conventions Belgium often provides for particular clauses regarding the application of the convention towards hybrid entities.

# 4. Belgian application of EU tax Directives towards hybrid entities

Usually, when analyzing the implementation of a directive in a national tax system, one has to verify all aspects of the regulation, as well as all possible breaches in domestic tax law.
Belgium already has a few times been convicted for not implementing correctly the EU Tax Directives and subsequently amended its tax system. Although still in some points doubtful, this article will not further examine the conformity of the Belgian legal tax system with the European Directives. The implementation of each directive will be shortly described, after which this article only looks for possible and actual problems concerning the Belgian approach towards hybrid entities.

## 4.1 Implementation of the parent subsidiary directive

Broadly speaking, the Parent Subsidiary Directive solves economic double taxation on two different levels: the distribution of a dividend cannot be submitted to withholding tax[96] and relief has to be given to the receiving parent company for the tax already levied when the subsidiary acquired the income. [97]

### *4.1.1 Exemption from withholding tax*

The exemption from withholding tax in the residence state of the subsidiary company has been implemented in articles 106, §5 and 117, §4 of the Royal Decree for the implementation of the Income Tax Code. Its scope however not only applies for foreign parent companies as mentioned in article 3.1.a of the Directive, but is enlarged to companies resident in a State that has concluded a double tax convention with Belgium if the convention (or any other treaty) allows the exchange of the necessary information for the application of the national tax laws.
The exemption from withholding tax in the residence state of the parent company is included in article 106, §1 of the Royal Decree for the implementation of the Income Tax Code. This paragraph provides for a general exemption from withholding tax for resident companies receiving dividends from foreign companies, without any further condition regarding participation thresholds or a minimum holding period.

Articles 5 and 6 of the Directive have no particular provisions for tax transparent or hybrid entities. Accordingly, the Belgian exemption is focused on Belgian classification and attribution criteria. An exemption from withholding tax is applied if, from a Belgian perspective, all further conditions for receiving the exemption are fulfilled. If Belgium

[96] Articles 5 and 6 Directive.
[97] Article 4 Directive.

classifies an entity opaque, further entitlement of partners in the entity will not be verified. In case of a tax transparent entity, the application of the Directive will only be verified at the level of the partners.

Two advanced administrative decisions, although applying these criteria, could however cause some uncertainty. In this rulings, the administration was asked about the Belgian tax treatment of dividends distributed to German partners, participating through a German 'Kommanditgesellschaft' that was a 100 % shareholder of a Belgian 'naamloze vennootschap'.[98]

A German 'Kommanditgesellschaft' is tax transparent according to Belgian classification criteria. The administration accepted that the partners could ask to be exempted from withholding tax, as they were all companies listed in the annex of the Parent Subsidiary Directive. In one ruling both partners possessed 50 % of the shares of the Kommanditgesellschaft and were both entitled to the exemption. In the other ruling however one partner held 99,99 %, while the other only had 0.01 % of the shares in the 'Kommanditgesellschaft'. The administration therefore concluded that only the first partner was entitled to an exemption.

In both rulings the administration referred to the Belgian classification of a German Kommanditgesellschaft as a tax transparent entity. However the administration also mentioned the tax transparent classification under German tax law, the German qualification of the partners as 'Mitunternehmer' and the fact that a 'Kommanditgesellschaft' was not mentioned in the Directive. If only the Belgian classification were of importance, it is not clear why the administration also focused on these other tax regulations.

### *4.1.2 Double tax relief at the level of the parent company*

Belgium provides relief for a receiving parent company on a particular way. Received dividends are initially integrated in the taxable profits of a company (or permanent establishment) and subsequently deducted again after some earlier modifications of the taxable result.[99] This exemption is not limited to dividends from European companies, but in principle holds for all foreign and domestic subsidiaries.

The deduction is granted for participations of at least 10 % into the capital of another company or participations for a minimum of 2.500.000 EUR. The participation should be be maintained for at least one year. The distributing company should have been submitted to a taxation regime not significantly more favorable as the Belgian tax regime and finally some further modifications are foreseen concerning the taxable income of the parent company against which the dividend deduction can be offset.

Although the Directive provides for a particular rule concerning hybrid entities[100], this regulation is not implemented in the Belgian context. As the exemption from withholding tax, also this double tax relief is exclusively based on income qualified as dividends according to the Belgian classification of the entities involved. Theoretically one could imagine a double taxation when a foreign entity without legal personality (classified tax transparent for Belgian tax purposes) classifies opaque according to the tax criteria of its resident state.[101] Income

[98] Rulings nrs. 300.303 en 300.326, www.fisconet.fgov.be

[99] Cf. Article 202 ff Income Tax Code. Capital gains on shares get a different treatment. Under comparable circumstances, they are immediately exempted for SME's, and taxed at 0.412 % for other companies. (Art. 192 ITC).

[100] Art. 4.2 Directive.

[101] This could for example be the case for a Dutch 'open commanditaire vennootschap'.

acquired by this entity will be attributed simultaneously to the entity and its Belgian partner(s).
However this will not always result in a double taxation. If the acquired income consists of dividends Belgium will apply its exemption based on the distribution to the tax transparent entity. If the earlier distribution of income fulfills all conditions, the exemption will be applicable. Besides, the foreign (hybrid) entity could also qualify as a permanent establishment of the Belgian partner(s). [102] Income attributed to a foreign permanent establishment of a Belgian entity, albeit for other reasons, is still exempt in Belgium, if the permanent establishment is located in a treaty partner of Belgium.

Despite its failure to implement article 4,2 of the Directive, when verifying the necessary conditions, the Belgian legislator does apply a certain look-through approach, although mostly in a negative context. [103]
As the exemption is meant to avoid an economic double taxation, one of the legal prerequisites is the so-called "taxation condition": distributed dividends can only be deducted if the earned income has been taxed at the level of the distributing entity.
Therefore dividends distributed by investment companies, submitted to favorable tax regimes, in principle cannot be deducted. However, this exclusion is mitigated with a further look through-approach. If the dividends come from income being taxed at an earlier level, in some cases, the receiving shareholder would still be able to exempt the income.[104]
Another regulation excludes dividends from being exempted if they are distributed by an ordinary taxed company, but this company redistributes dividends that would not directly qualify themselves for the deduction for at least 90 %.[105]

Although technically not under the scope of the Directive, it remains interesting to repeat the particular Belgian tax clause for reverse hybrid entities in Belgians Model tax conventions, as well as its most recent treaties. This problem is the adversary of the issue mentioned in the Directive. If a source country classifies an entity tax transparent, it would immediately tax the Belgian partners on the acquired income. As Belgium however considers the entity separately taxable it does not tax the income, but taxes the partners when the hybrid entity distributes its profits to them. Although the income would be taxed twice, the income deduction is not allowed, because the entity as such was not submitted to tax. [106] The parent-Subsidiary directive cannot provide for a solution either, because the subsidiary is not a "company of a Member State", as defined in article 2 of the Directive.
To nevertheless avoid double taxation the Belgian Model convention provides for a particular clause stating that the distributed income, calculated on a net basis, will be exempted in Belgium if the Belgian participants in the hybrid entity were already taxed on these profits when earned by the entity.[107] As this clause actually only figures in a limited number of concluded treaties its precise scope still raises doubts that are not yet elucidated.

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[102] Although a transparent entity often qualifies as a permanent establishment, it can be accentuated that this is not an automatism. The precise qualifying conditions for a permanent establishment under a double tax convention between Belgium and the residence state of the transparent entity will still have to be verified. Cf. T. WUSTENBERGHS, *Heffingsbevoegdheid bij grensoverschrijdende ondernemingswinsten. De vaste inrichting op de helling*, Larcier, Gent 2005, 616 e.v.

[103] Article 203 Income Tax Code.

[104] Article 203,§1, 2° Income Tax Code, with further exceptions in §2.

[105] Article 203, §1, 5° Income Tax Code, also with further exceptions in §2.

[106] Despite remarks in the Belgian legal doctrine referring to this economic double taxation, the Belgian Minister of Finance refused to allow the income deduction in this specific case. Cf. Vraag nr. 819, *Vragen en antwoorden* Kamer 1996-1997, nr. 91, 12495.

[107] Article 22, 2, b) Belgian Model Convention 2010.

## 4.2 Implementation of the Merger directive

The Merger directive seeks to neutralize company restructuring within a cross border context. In light of their economic activities these reorganizations can be necessary, but usually lead to the recognition of taxable profits, such as capital gains or the removal of temporarily exempted tax reserves, and the possible loss of earlier tax deductible losses. To remove this tax burden the Directive provides for a tax neutral treatment at the level of the 'old company/ies' (transferring or acquired company), its shareholders and the new company/ies (receiving or acquiring company) upon the condition that none of the concerned Member States loses any future taxable profits.
However, in case of a hybrid entity, being classified tax transparent by one of the States a restructuring operation will be recognized at a different level or other persons are considered to be the relevant shareholders. The directive provides in articles 4.2 and 8.3 for a same tax neutral treatment, but leaves a loophole in article 10a as described in chapter 2 of this book.

Concerning mergers and divisions, this Directive was very lately implemented in Belgium. Although in a pure Belgian context a tax neutral treatment in line with the provisions of the Directive already existed as from 1991, in case of a foreign receiving or acquiring company tax neutrality was only foreseen as from 12 January 2009.[108] A transfer of assets to a foreign European entity could already be realized tax neutral under the condition that the transferred assets would be kept in a Belgian permanent establishment of the receiving entity.
The Belgian implementation of the directive only refers to Belgian classification criteria. Therefore, if according to this classification a non-European entity would be considered to be the new receiving or acquiring entity, the neutral treatment at the level of the reforming entity or its shareholders will not be granted. As far as the author knows, in the complete implementation of the Directive and the further elaboration of the tax neutrality for the different treated reorganizations no peculiar attention has been given to the concept of tax transparency or a potential conflicting classification. Therefore a detailed analysis can be made of all different aspects and situations by which this silence breaches the rules of the Directive. However this peculiar aspect has not been given much attention in the Belgian practice or doctrine yet.

## 4.3 Implementation of the Interest and Royalty Directive

The interest and royalty Directive avoids a double taxation on interest and royalty payments between two European associated companies. The source state of the income has to exempt these payments from any tax if both companies are associated, either because one of both has a direct holding of at least 25 % in the capital of the other company, or because a third company has a direct holding of at least 25 % in the capital of both companies.
The scope of this Directive is limited to the legal entities mentioned in an annexed list. This list consists of the entities mentioned in the first version of the Parent Subsidiary Directive (although extended to similar entities of more recently acceded Member States). As these entities are supposed to be classified separately taxable under the tax regime of all the Member States, no particular provisions are foreseen for hybrid entities.
The Directive is implemented in Belgium through different provisions[109], because Belgium distinguishes its taxation of the different forms of income which the Directive has in view.

[108] Art. 211, §1, 4th section Belgian Income tax code as introduced by a Law of 11 December 2008, *Belgian Gazette* of 12 January 2009.
[109] Articles 105, 6°; 107, §6; 111, d); 113, §7; 117, §6bis and §15; 118, §1bis Royal Decree for the implementation of the Income Tax Code and article 266 Income Tax Code.

Each of these articles provides for an exemption of withholding taxes in case of companies mentioned in the annexed list of the Directive, under the condition of a participation of at least 25 % to be kept for at least one year.

The directive provides for an exemption from withholding taxes in case of a 'direct participation'. This condition raised some doubts in legal doctrine concerning the application for participations held through a tax transparent entity.[110] However, Belgium dropped the requirement of a direct participation and also provides for an exemption in case of an indirect participation of 25 %. Nevertheless, the attribution of income is determined according to the Belgian classification, which still risks causing frictions.

If Belgium, acting as source state, attributes income to an entity in another Member state that is not mentioned in the annexed list it will not exempt the income. However it might be possible that the residence state (or a third state) classifies this entity tax transparent and immediately attributes the Belgian income to the partners participating in the entity. Even if these partners would be mentioned on the list, Belgium still would not exempt the distributed income.

On the other hand it is also possible that Belgium classifies an income receiving entity tax transparent, immediately attributing the income to the participating partners. Although with the actual annexed list of entities it would probably seldom happen, even if the entity is mentioned on the annexed list of the Directive this would not be sufficient to provide for an exemption. Eventual possibilities for an exemption would only be verified at the level of the participating partners for each partner individually.

The author has no knowledge of practical cases in Belgium concerning the application of this Directive for interest and royalties acquired through hybrid entities.

## 4.4 Conclusion

The EU tax Directives do not provide for all comprehensive solutions in case income is earned through hybrid entities. The awakening to the possibility of tax transparency and hybrid entities is only a very recent issue and particular provisions are slowly penetrating into the European legislation. However in its implementation of the EU tax directives it strikes that the Belgian legislator does hardly pay attention to this particular problem.

Therefore further convictions by the European Court of Justice can be expected in the future.

[110] R. RUSSO, "Partnerships and other Hybrid entities and the EC Corporate Direct Tax Directives", *European Taxation* 2006, 480.