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The Notional Interest Deduction

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Bill introducing the notional interest deduction

- The context
- The purpose
- The mechanism
- A few comments
- Where do we stand
- Capital duty: 0 %
- Compensatory measures



The Context

- Surveys indicated that Belgium was losing part of its attraction to foreign investors;
- So-called BCCbis regime is not considered sufficiently attractive to retain previous activity;
- The new ruling system is seen as a positive sign to attract foreign investments in Belgium;
- A new EU-proof incentive is needed



The purpose

- Reduce the economic discrimination between debt-financing and equity-financing
- Improve the financial position of companies and branches by increasing their equity
- Provide an alternative for Belgian coordination centres (BCC)
- Lower the effective corporate tax rate
- Upgrade the profile of Belgium as “headquarterland”



Mechanism (principle)

- Law would introduce new section in the tax code: “capital at risk deduction”;
- New tax deductible item (every year);
 - Applicable after the participation exemption and before imputation of loss carry forwards;
 - Calculated as a % of the capital at risk(adjusted shareholderfunds);
- Deduction via tax return

Deduction of an amount of deemed interest computed on the adjusted shareholderfunds of a company

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Mechanism

(Equity and interest concept)

- The shareholderfund is the amount reported in the Belgian GAAP balance sheet established in execution of the Belgian Company Code;
- Equity is not the tax equity as reported in the corporate tax return;
- Interest is computed as risk free interest



Mechanism (interest rate)

- Reference rate is the 10 year OLO as issued by the Belgian State;
- The reference rate will be adjusted, yearly and automatically;
- Maximum 6,5%. For later periods, positive or negative variation of max 1 % (except if a Royal Decree fixes another rate)
- SME: + 0,5 %



Mechanism (Beneficiaries – conditions)

- Applies to all companies subject to Belgian taxation, resident and non resident;
NO DISCRIMINATION = EU PROOF
- Can be carried forward 7 years if lack of profits;
- Intangibility condition of an amount equal to the deduction during 3 years (after the year of deduction);
- No condition of investment in tangible or intangible assets



Mechanism (equity adjustment to fix the capital at risk)

Equity, including retained earnings and accumulated reserves, as stated in the non-consolidated opening balance sheet of the taxable period, after elimination of:

- Capital grant (subsidies);
- Fiscal net value of own shares held on balance sheet;
- Fiscal net value of shares in other companies (financial fixed assets);



Mechanism

(equity adjustment to fix the capital at risk)

- Fiscal net value of shares issued by investment companies (income fulfilling conditions for participation exemption);
- The net equity of exempted foreign permanent establishments;
- Net value of assets exceeding business needs (art. 53, 10° ITC);



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Mechanism

(equity adjustment to fix the capital at risk)

- Net value of assets not generating regular income (eg. Works of art, jewelery, ...);
- The net asset value of real estate located abroad and tax exempt in Belgium;
- Real estate used by company directors (art. 32, §1, 1° ITC);
- Revaluation reserves

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A few comments

- Upward and downward adjustments during the year of the capital at risk are taken into account on a pro rata basis;
- SME: have to choose between “investment reserve” or “notional deduction”;
- No investment or employment condition;
- After 3 years can be distributed as dividends;
- No debt/equity ratio
- EU proof (code of conduct, state aid)



Where do we stand?

- Decision by the Council of Ministers on December 23, 2004 (approval of the concept);
- Pre-draft bill discussed by the Council of Ministers on Friday February 25, 2005
- Draft approved by Belgian Government on April 29, 2005;
- Approved by Parliament on June 2, 2005;
- Law published in the Official Gazette of June 30, 2005, applicable as from fiscal year 2007



Capital duty: 0%

- Together with introduction of the notional interest deduction – 0 % on capital contributions to Belgian companies (currently 0,5 %)
- Will enter into force as from 2006



Compensatory measures

Cost estimated at 566 million €

- Basic rate of investment allowance for SME's and ordinary staggered deduction 0 % (currently 3 % and 10,5 %)
- Abolition of tax credit for SME's subject to corporate income tax at the reduced rate
- Clarification of capital gain exemption, art. 43 ITC (exemption after deduction of costs)



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THANK YOU

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