The purpose of this new comparative survey is to provide country reports on the concept of substance in international taxation. Although the substance requirement has since long been an important part of the functioning of different taxation rules, the focus on this concept has recently increased. The BEPS initiative, launched by the G20 and led by the OECD, may result in changes to the substance requirement as it is expressed in different kinds of norms such as domestic laws, tax treaties and soft law. The European Union is interested in these developments and adheres to the work of the OECD on BEPS, while conducting certain initiatives on its own.

Given these recent developments, the International Transfer Pricing Journal wishes to present an overview of certain issues related to the substance requirement in several jurisdictions. The purpose of this study is to show the complexity, the diversity, but also the similarities between some of the requirements of different countries. At this point, the substance requirements in transfer pricing are deliberately not included in the questionnaire so as to limit the scope of this study. The outline has been prepared in cooperation with Jérôme Monsenego (Associate Professor of tax law, Uppsala University).

Belgium

Substance in International Taxation

1. General Principle of Economic Substance

As Belgian (tax) law does not provide for explicit requirements regarding economic substance, (economic) substance must be analysed on a case-by-case basis. In general, under Belgian tax law, a transaction can be challenged on four grounds when not enough substance is deemed present, namely (i) taxable presence, (ii) beneficial ownership, (iii) (general) anti-abuse legislation and (iv) transfer pricing (an aspect which is beyond the scope of this article).

1.1. Taxable presence

The risk of having “insufficient” substance abroad, while maintaining substance in Belgium (such as through management decisions that are taken here), could pose a residence risk, either through taxable residence in Belgium or via a permanent establishment (PE). In the first case, there is a risk of dual tax residence, as the respective company would be taxable on its worldwide income abroad and in Belgium. In the second case, the existence of a Belgian PE would mean that there is taxable substance present in Belgium, i.e. the income that can be linked to the PE.

See sections 2. and 3. for further details.

1.2. Beneficial ownership

The concept of beneficial ownership is found in numerous Belgian income tax treaties, in EU legislation (as implemented into Belgian tax law) as well as in domestic legislation. The concept is marked by the absence of a hard and fast definitional provision under Belgian tax law, and its interpretation is subject to much debate. It is a definite line of attack of the Belgian tax authorities in situations where dividends, interest or royalty payments are made without having sufficient substance on the ground.

See section 4. for further details.

1.3. General anti-abuse provisions

Belgium has paid increased attention to substance and the prevention of structures that are regarded as abusive. A new general anti-abuse measure (GAAR) was introduced into Belgian tax law in 2012. This GAAR offers the tax authorities an effective means of combating tax avoidance, as the GAAR can render a legal act not enforceable towards the tax authorities when it can be shown that there has been an abuse of law. The provision specifically targets wholly artificial arrangements that lack economic substance and do not take place under “normal” economic or financial conditions.

1.4. Notion of substance in Belgian tax practice

The Belgian tax authorities take into account several elements to test the existing substance at different management levels (i.e. senior management level (board of directors), daily management level and administrative management level). Generally speaking, a company could be regarded as having a sufficient level of substance in Belgium if the significant value-creating activities are effectively conducted by qualified people in Belgium who are authorized to exercise those duties.

Experience reveals that the following criteria should typically be taken into consideration in assessing the level of substance of a Belgian company (the list is not cumulative or exhaustive, and none of these elements is decisive):

– active senior decision making is located in Belgium, i.e. the board of directors (preferably Belgian residents) regularly meets in Belgium, where a quorum...
of directors is physically present. The board of directors meets at least as frequently as required by the operational needs of the company;

– the board of directors takes strategic decisions (long-term planning) relating to the business of the company (e.g. investment decisions, dividend management), whereas communications to the company from a foreign head office consist of general advice or guidance, rather than specific instructions or orders;

– with regard to the decision-making process, the directors have sufficient knowledge to function as directors of the company, and actually do so (i.e. they perform no "rubber stamping"). No pre-emptive action is taken by either the directors or the shareholders before the proposal, evaluation and decision process has been completed (i.e. decisions are taken at board meetings). Belgian board members have the same level of authority as foreign directors;

– day-to-day operations (e.g. management participation, negotiation and signature of contracts, business risk management, decision making on capital investments and funding) are managed by local qualified personnel ('daily management'). The company's daily management has the expertise and is empowered to oversee the actual entrepreneurial risk;

– the number of employees available in the company and their expertise are commensurate with the activities carried on by the company (i.e. experienced and qualified personnel);

– the company has administrative management which is located in Belgium. It has an address in Belgium and is registered with the central Belgian register of undertakings;

– the company’s (main) bank accounts are in Belgium. Its administration and bookkeeping are maintained in Belgium, and its books and records are archived in Belgium. It meets all its Belgian tax and accounting obligations; and

– all correspondence with regard to its activities is addressed to, and sent from, the company. E-mail correspondence regarding the company is sent from and to its unique e-mail address. The situation should be avoided where (e-)mail correspondence is (merely) forwarded to external management.

2. Substance and Corporate Residence

2.1. Criteria for corporate residence

Under section 2(5)(b) of the Income Tax Code, a company is deemed to be resident in Belgium if:

– it has its registered office in Belgium;

– it has its principal place of business in Belgium; or

– it has its place of management or administration in Belgium.

If the registered office and place of management are situated in two different states, the company’s residence is determined by its place of management (substance-over-form).

The place of management is the place where the company’s general interests are promoted and looked after. It is the place where genuine activities take place, important decisions are taken and board of directors’ and shareholders’ meetings are held.

2.2. Judicial interpretation of "place of effective management"

The Belgian Commentaries on income tax treaties state that the place of effective management is the place from where a company is effectively directed or managed.1

Just like the OECD, the Belgian tax authorities tend to take a substance-over-form approach to tax residence. In practice, a company’s management should have its actual offices at this place of effective management, rather than merely holding office space. Belgian courts look for the actual place where the key decisions are taken, where the effective management takes place, regardless of where the board of directors formally gathers.

The Brussels Court of Appeal considered a company’s statutory residence in Belgium to be a presumption that may be rebutted if the company is de facto managed from abroad, which is the case if board of directors’ and shareholders’ meetings are held in Belgium only for purely formal purposes.2

Conversely, if a company has no place of business or activity at all outside Belgium, and its registered office turns out to be nothing more than a letter box, it can be deduced that its place of management is actually in Belgium if not only the directors reside in Belgium, but also most of the company’s activities take place in Belgium. Case law states that merely appointing an accountant to hold the company’s accounts in the proclaimed country of residence or organizing its general meetings there is not sufficient to outweigh these factors.3

There have been some situations in which a foreign company is managed by Belgian directors, or under a Belgian management structure. Here, Belgian courts accept that the company cannot be regarded as a foreign tax resident, as the actual place where the key decisions are taken, where the effective management takes place, is situated in Belgium, regardless of where the board of directors formally gathers.4 Other cases deal with situations where the board of directors and the general meetings of shareholders only formally meet in Belgium, while actual decisions are taken outside Belgium. In such cases, Belgian courts will find that the place of effective management is not situated in Belgium, and thus the entity is not a Belgian tax resident.5

The Brussels Court of Appeal ruled that a Luxembourg-incorporated company that had its registered office in Luxembourg was nevertheless a Belgian resident because its place of effective management was considered to be in Belgium. One of the factors taken into account by the Court

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4. Id.
was that the company’s correspondence was directed to a Belgian address. Therefore, as key decisions appeared to be made in Belgium, the company was deemed to be a Belgian resident.\footnote{BE: CA Brussels, 9 Apr. 1963, Bulletin der Belastingen-402 (1963), at 2366.}

The Court of First Instance of Mons held that a French société anonyme could not be regarded as a Belgian resident because its place of effective management was situated in France on the basis of the following arguments (among others): the board and general shareholders’ meetings were held in France; its warehouse and offices were located in France; and personnel worked at those facilities. The fact that the directors of the French company carried out certain daily management tasks in Belgium (at the offices of another Belgian group company) was not sufficient to conclude that the French company’s affairs were in fact conducted from Belgium. The day-to-day management carried out in Belgium was only minor and occasional.\footnote{BE: Mons Court of First Instance, 6 May 2003, FJF 2003, at 1003.}

Where management is carried out in Belgium for a non-resident company (even where that does not create a taxable residence in Belgium, i.e. adequate substance is available abroad), it should be carefully examined whether this creates a taxable PE (see below).

### 3. Substance and Permanent Establishments

#### 3.1. Place of management

According to the official Belgian Commentaries on income tax treaties, the list in article 5(2) of the OECD Model should be interpreted in its own right, i.e. to qualify as a ‘place of management’, Belgium does not require the general conditions of article 5(1) to be fulfilled, and so a PE may arise in Belgium from mere management tasks. Unless there is evidence to the contrary, a place of management is fundamentally a PE.

This is different from the interpretation of the Commentary on the OECD Model Convention, whereby the list in article 5(2) is subordinate to article 5(1).

Whether or not the interpretation of the tax authorities is in conformity with international tax law, this does have practical implications. The (broader) Belgian interpretation of “place of management” might lead to the situation where the tax authorities consider that a PE arises even when no physical materials/structure are/is available (such as an office or office supplies). Hence, the board of directors of a foreign company that takes decisions in Belgium could give rise to a PE, regardless of whether it has an actual physical establishment here. Both day-to-day management and strategic management may qualify as a place of management.

It remains to be seen what impact the OECD Discussion Draft, as well as the developments following the OECD BEPS Action Plan, might have on the Belgian interpretation.

#### 3.2. Characteristics of a ‘place’ for permanent establishment purposes

The wording that is used by the Belgian tax authorities to define a place of business in the Commentaries is similar to that used in the Commentary on the OECD Model, i.e. the notion of “place of business” includes premises, a facility and an installation used exclusively or not for the activities of the company. A place of business may also exist when no premises are available or needed to carry on the business, and the enterprise has only a determined space at its disposal.

The Belgian Commentaries state (in accordance with the Commentary on the OECD Model) that it is not required for an enterprise to hold any formal or implied legal right with regard to the place of business in order to carry on its business through it.\footnote{BE: Brussels Court of First Instance, 22 Apr. 2005.} It is indeed sufficient that the company de facto uses the place of business and that this use cannot be unilaterally altered by a third party.

#### 3.3. Permanency criterion

The Belgian Commentaries state that there are two decisive criteria when assessing whether the permanency criterion is fulfilled.\footnote{BE: Liège Court of First Instance, 9 Dec. 2004, Expat News 7 (2005), at 20; BE: Brussels Court of First Instance, 22 Apr. 2005.} The first is the intention of the foreign taxpayer. The initial intention of the taxpayer to have a presence for a lasting period in the source state suffices for the permanency requirement to be fulfilled, even if the stay is eventually shortened because of (exceptional) circumstances. The second element, the actual duration, should be considered based on the facts. If the foreign taxpayer’s presence in the source state lasted longer than initially intended, the taxpayer’s presence could retrospectively trigger the existence of a PE, depending on the actual length of the taxpayer’s stay.

Neither the tax authorities nor the Belgian courts offer much guidance as regards the permanency criterion. In fact, Belgium has not specified a minimum duration period in the vast majority of its income tax treaties. However, case law\footnote{BE: Parliamentary question 13, 329, 29 Nov. 2006.} on this topic traditionally uses a threshold that approximates a 12-month period.

In a reply to a parliamentary question, the Minister of Finance stated that the minimum period of six months mentioned in the Commentary on the OECD Model has a merely indicative value, and that the question of whether a place of business with less than six months of activity qualified as a PE, would depend on the nature of the activity.\footnote{Commentaries Belgian income tax treaties, no. 5/104.}

Hence, in the absence of an unequivocal rule, the duration test should be applied on a case-by-case basis.

#### 3.4. Service permanent establishment

As of 1 January 2013, the concept of a service PE was introduced in Belgian law. Under article 229, paragraph 2/1 of...
the Income Tax Code, a foreign company carrying out services in Belgium for a period of more than 30 days in any 12-month period for one (or connected) project(s) will be considered to constitute a PE of its foreign enterprise under Belgian domestic tax law (a so-called “Belgian establishment”).

However, this will not always result in an effective Belgian tax liability. If treaty protection is available (i.e. if there is an applicable income tax treaty), it should be analysed whether the Belgian establishment should also be regarded as a PE under the PE article of that applicable treaty. A Belgian establishment may be subject to Belgian taxes only if the Belgian establishment can also be considered to be a PE for treaty purposes (therefore, a service PE clause must be included in the applicable treaty).

In this regard, Belgium has entered into some income tax treaties which contain a so-called “service PE clause”, under which the mere provision of services for an extended period of time (typically three, six or nine months, depending on the applicable treaty) is considered to trigger the existence of a PE. 

3.5. Activities of a preparatory or auxiliary character

Article 5(4)(e) and (f) are interpreted according to the OECD Model and its Commentary.

3.6. Significant people functions

There has been no change in the Belgian domestic law since the OECD introduced the concept of significant people functions. The arm’s length principle was incorporated into Belgian tax law in 2004 and, as Belgium is an active OECD member, its tax authorities tend to adhere to the OECD approaches. The increased focus on substance requirements in recent OECD proceedings has clearly impacted the approach taken by the Belgian tax authorities.

The tax authorities have dealt with more cases following the issuance of the OECD implementation of significant people functions, and they are taking an increasingly practical approach (i.e. substance-over-form). For instance, while business organizations involving commissionaire agents, toll manufacturing and similar arrangements have been very common for years now, the Belgian tax authorities are clearly focusing more on substance in these kinds of restructurings. Taxpayers are now almost systematically scrutinized when they engage in business restructurings, and the extensive requests for information by the tax authorities contain questions that clearly draw on Chapter IX of the OECD Transfer Pricing Guidelines (OECD Guidelines), such as the relationship between the cost and benefit of a restructuring for a specific group entity.

Experience shows that a practical approach should be taken where emphasis is placed on the relevant authority (decision-making capacity) and competence (knowledge and skills), aside from the contractual arrangements and assets used to carry on the business. Where, in practice, active decision making can be linked to a number of steps, it should be assessed which of them should be supported by a qualitative assessment of the economic significance of the function concerned. Indeed, the extent of the decision making will depend on the nature of the risks involved and cannot be quantified upfront, nor expressed in terms of e.g. physical presence of X days per week. A company should ensure that it can decide, manage and execute the commitments/obligations taken in its core business.

Since 2013, the Belgian tax authorities have significantly increased the number of transfer pricing audits. During these audits, it is clear that the significant people functions are a definite key to determining the “right” transfer pricing approach.

4. Substance and Abuse of Tax Treaties

4.1. Substance requirements for residence certification

It is possible to obtain a tax residence certificate in Belgium, provided that all substance requirements are duly met and carefully implemented (see section 1). Obtaining a residence certificate is not a guarantee of proving to the Belgian tax authorities that a company has sufficient substance.

4.2. Beneficial ownership

The concept of beneficial owner can be found in many Belgian income tax treaties. However, no domestic Belgian definition of the concept of beneficial owner is included in the Income Tax Code or case law.

Most Belgian legal writers take the view that beneficial ownership is to be interpreted as a legal concept, as opposed to an economic concept. The official Belgian Commentaries on income tax treaties define a beneficial owner as the official proprietor or usufructuar (i.e. life tenant) or the party benefiting from the fruits or profits of an asset. This position was confirmed in an answer from the Minister of Finance to a parliamentary question, as well as in some scarce Belgian case law on the concept of beneficial ownership.

International cases such as Indofoods and Prévost Car have not immediately impacted the Belgian interpretation of beneficial ownership. For instance, the Court of Appeal of Ghent affirmed a decision of the Court of First Instance of Ghent considering that only the “legal beneficiary” (i.e. the foreign company as a distinct legal person) is taxable on the movable income granted. The concept

12. Belgian income tax treaties that contain a service PE clause include the treaties with Albania, Argentina, Chile, China (People’s Rep.), Czech Republic, Egypt, Hong Kong, Indonesia, Kazakhstan, Morocco, Pakistan, the Philippines, Rwanda, Senegal, Singapore, Sri Lanka, Taiwan, United Arab Emirates and Vietnam.


of “economic” beneficiary as asserted by the Special Tax Inspection was not accepted. This judgment is in line with the tradition of Belgian tax case law which gives priority to legal reality over economic reality.

However, recent developments indicate that an economic interpretation of the concept of beneficial owner might be possible under Belgian law (e.g. obligation of Belgian entities and establishments to file a specific form for payments to no-tax or low-tax countries). If a certain threshold is exceeded, indirect payments also fall within the scope if a taxpayer knows or should have known that the recipient of a payment is not the beneficial owner (i.e. economic approach).

It cannot be excluded that the Belgian tax authorities might evolve to adopt a more economic interpretation of the concept of beneficial ownership in the near future, also taking into account the developments following the OECD Discussion Drafts concerning the meaning of “beneficial owner” in the OECD Model and the OECD BEPS Action Plan.

4.3. Limitation-on-benefits provisions

Some Belgian income tax treaties contain a limitation-on-benefits clause (e.g. Belgium-United States Income Tax Treaty (2006)).

The term “primary place of management” is defined, for example, in the Belgium-United States Income Tax Treaty (2006). The primary place of management looks to where the day-to-day responsibility for the strategic, financial and operational management of the company (and its subsidiary) is exercised. Consideration is given to the managers involved in the actual day-to-day decision-making process and to the staff to support this process, which is strongly comparable to how the “place of effective management” is interpreted under Belgian law (see section 3.).

5. Substance and Obtaining Certainty with Regard to Tax Treatment

5.1. Criteria for advance certainty from tax authorities

Upfront certainty can be obtained from the Belgian tax authorities via a request for an advance decision (or ruling) from the Belgian Ruling Commission. As a general principle, a ruling is considered upfront to the extent that it is obtained prior to the date on which the transaction will have tax effect (i.e. the date of filing of the corporate income tax return with regard to the financial year in which the transaction took place).

5.2. Substance requirements for various activities

There are no specific differences in substance requirements for varying activities, but, of course, the degree of substance required to support a company’s business is linked to the type of activity and size of its operations. It is probably premature under the current state of play of the OECD ongoing initiatives, although the notion “functional value creation” will likely gain more traction in the future. Consequently, the specifics of the functionality that a certain company is supposed to undertake will most likely be more at the forefront of the analysis of substance.

Experience shows that, to test the substance of finance companies, the Belgian Ruling Commission looks, among other things, to whether they manage their affairs in their own name and for their own account (i.e. not as an agent) and whether they incur their own (credit) risk on their portfolio assets. The Commission also verifies whether finance companies have sufficient personnel capable of carrying out the relevant finance activities. Needless to say, this will be a matter of quality rather than simply the number of people (i.e. quantity).

With regard to holding companies, practice shows that it is important to have qualified and informed board members and a daily management capable of managing the investments and participations of the company.

This topic is undoubtedly an ongoing source of debate and even controversy due to the need to test concepts that may or may not be internationally aligned against facts. Taxpayers will need to factor in that it will only be the facts that tell the story, and nothing else than the facts.

16. No-tax or low-tax countries are considered to be (i) states mentioned in a list of states without taxation or with a low level of taxation (i.e. a nominal corporate tax rate below 10%) and (ii) states which, during the entire taxable period in which the payment is made, are considered by the Global Forum on Transparency and Exchange of Information for Tax Purposes as not applying the OECD standard for the exchange of information “effectively or substantially”.
