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INCOME TAX PRACTICES MAINTAINED BY BELGIUM

Memorandum Submitted by the Representative of Belgium

Addendum

In the course of my statement to the Council on 2 March last, I reiterated the clearly expressed reservations of my Government with regard to the conclusions of the Panel on "income tax practices maintained by Belgium", whose report has been circulated as document L/4424.

As you will recall, Mr. Chairman, the report's conclusions incriminate the Belgian system, which:

- reduces the corporation tax to one quarter as regards the profits of foreign establishments of Belgian corporations;
- exempts from corporation tax the dividends derived by Belgian corporations from permanent participations in foreign corporations.

Belgium is of the view that these conclusions:

- (a) result from the drawing of an inevitably inappropriate parallel between the Belgian rules for the relief of international double taxation of profits earned abroad by Belgium-based corporations and the United States DISC, which establishes a preferential system for profits from sources within the United States;
- (b) are based on a broad and erroneous interpretation of the concept of "export activities", including in that concept, in the context of the General Agreement, transactions carried out abroad by importing branches or subsidiaries.

That is why I deemed it necessary to raise two interlocutory questions which must be answered in precise terms before the Council takes a final decision on the Panel's report, for without such answers the Council may fail to deal with certain essential aspects of the case at issue.

But, in order to measure the impact of the Panel's conclusions on practices associated with the tax legislation not only of Belgium but also of many other contracting parties, it is important first to analyse the principles and the exact nature of the Belgian measures that have been incriminated.

I. Principles

As already demonstrated during the work of the Panel, and like most industrialized countries, Belgium has based its income tax system on the following two principles:

- (a) the principle of worldwide taxation: Belgium taxes its residents on both their foreign-source and their domestic-source income (Articles 5 and 96 of the Income Tax Code);
- (b) the principle of the territoriality of income: Belgium taxes non-residents only on income produced or collected in Belgium (Article 140 of the Code).

The application of these principles means that the foreign-source income of non-residents is outside the sphere of Belgian taxation. In particular, Belgium refrains from taxing the profits of foreign subsidiaries of Belgian-based corporations, thereby totally respecting the fiscal sovereignty of the foreign countries in which those subsidiaries are established.

It may be added that, in general, those countries make substantial use of their power of taxation; where that is not so, the misuse of subsidiaries in foreign countries (whether they be tax havens or countries which, while not known as such, have very moderate rates of taxations) is combatted by stringent provisions in the Belgian Tax Code.

There is no provision in the Code which is designed to encourage export operations. Thus, the fact that a corporation's main or secondary activity consists of selling goods or services abroad does not entitle it to any diminution of taxation on its profits that would place it in a situation different from that which could be claimed by other Belgian corporations, including those which did not engage in export.

Hence the importance of the provisions contained in Article 24 of the Belgian Income Tax Code, regarding the prices invoiced by Belgian manufacturing corporations.

This Article 24 - which in substance is similar to the provisions of Article 9 of the OECD model convention, widely copied in double-taxation agreements - makes it possible to ensure proper invoicing by Belgian manufacturing corporations.

The first paragraph of this provision reads as follows:

"Where a Belgium-based enterprise has, directly or indirectly, any relations of interdependence with a foreign-based enterprise, any abnormal or gratuitous advantages which, because of those relations, it grants to the latter enterprise or to persons or enterprises having common interests with that enterprise, shall be added to its own profits."

I must insist, Mr. Chairman, on the absolutely general applicability of that provision, which reflects the so-called "arm's length" principle and is designed to frustrate improper transfers of profits to foreign countries.

The above provision has recently been supplemented by the following paragraph:

"Paragraph 1 shall likewise be applicable to abnormal or gratuitous advantages granted to a person or enterprise which, under legislative provisions of the country where it is established, is subject to a tax régime significantly more advantageous than that to which the Belgium-based enterprise is subject."

This second paragraph thus extends the provision, without the need for determining relations of interdependence, to cases in which advantages are transferred to persons or enterprises which, under the legislative provisions of the country where they have their fiscal domicile, are there subject to an abnormally advantageous tax régime; it is thus aimed particularly at improper transfers of profits carried out through the use of tax havens.

In practice, the provisions cited above serve as a basis for the Belgian Administration's efforts to ensure normal invoice prices in all cases.

Lastly, Mr. Chairman, this point would not be complete if I did not cite at least the measures recently taken to strengthen the prevention of tax fraud involving the use of "countries of refuge". Let me only refer to the new Articles 46 and 250 of the Income Tax Code, whose importance, by the way, did not escape the attention of the Panel. (See paragraph 26 of document L/4424).

II. Concept of export activities

Having mentioned the principles of Belgium's tax legislation, I now come to the nature of the incriminated measures and, inasmuch as the two prior questions I asked the Council on 2 March have as yet not been answered, I should like at this point to express the considerations of my country's authorities on the subject

In its report (see, in particular, paragraph 34), the Panel, after referring to the particular way in which Belgium applies the territoriality principle - and this too calls for reservations since the rule in Belgium is to tax worldwide income - notes that Belgium's practices allow "some part of export activities, belonging to an economic process originating in the country, to be outside the scope of Belgian taxes".

The very wording of this statement places it in the context of an economic approach. To appreciate its significance as regards taxation, it is necessary to examine whether the concepts which it borrows from the language of economics are in keeping with the essentially legal norms that govern the collection of taxes.

The part of export activities which the Panel has in mind can only refer to those activities which are exercised outside Belgium at the level of the foreign importer (which may be an enterprise completely independent of the exporting enterprise, or a foreign subsidiary or establishment of the exporting enterprise).

Within the ordinary meaning of the General Agreement, as well as from a strictly fiscal point of view, export activities quite obviously end not later than the moment when the foreign importer - whoever he may be - takes possession of the exported goods.

From that moment onwards, operations take place in terms of the import of products into the country of destination and automatically fall under the fiscal sovereignty of that country. Contrariwise, under generally accepted principles, Belgium must normally give up the exercise of its fiscal sovereignty in respect of those operations.

Similarly, for purposes of taxation of income in particular, the concept of "export activities" necessarily can cover only those activities which take place within the country of origin, at the level of the manufacturer/seller, and before the goods cross the frontier.

Consequently, in no case can Belgium agree that export activities should be understood as continuing beyond the frontier of the importing country. For Belgium, activities exercised after that frontier is crossed have nothing more to do with export activities within the meaning of GATT but are part of the internal trade of the country of destination.

It will be seen in this connexion that once all these subsequent activities come under the fiscal sovereignty of the importing country, no distinction is made between enterprises, and it makes no difference whether the goods are distributed through a subsidiary or branch of the exporting enterprise, or through an enterprise completely independent of the exporting enterprise.

In conclusion on this point, Belgium contends that the incriminated provisions of Belgium's legislation lie completely outside the normal concept of "export activities", within the ordinary meaning of the General Agreement.

III. True nature of the incriminated provisions: avoidance of double taxation

The incriminated provisions of Belgium's legislation are, first, the taxing of profits of foreign branches of Belgian corporations at the rate reduced to one quarter and, secondly, the exemption of up to 90 or 95 per cent of dividends from permanent participations held in foreign subsidiaries by Belgian corporations.

As will be seen later, what we are dealing with here are measures which have their counterparts in the legislation of most States, and one may therefore wonder about the reasons that impelled one of them to concentrate its criticism exclusively on the legislation of the Netherlands, France and Belgium.

In any case, these measures have no other purposes or effects than relief from the double taxation of foreign income. Obviously, the principle of taxing residents on worldwide income, which is applied not only by Belgium but also by most other countries, inevitably leads to a double - and therefore unfair - taxation of their foreign income, already taxed in the source country.

The corrective measures unilaterally taken by most countries are, of course, regularly confirmed or expanded by the agreements for the avoidance of double taxation that have been concluded by the great majority of industrialized countries and by many developing countries.

(a) Income from foreign establishments of resident corporations

While Belgium reduces to one quarter of the normal rate the tax due on the profits of foreign establishments taxed abroad, many other countries act in a very similar manner. Let us mention, purely by way of example, the following provisions in the legislation of other countries:

- reduction of tax by 50 per cent;
- exemption of up to 50 per cent of profits, which in the case of a proportional tax, means a tax reduction of 50 per cent;
- complete exemption;
- a tax credit, under various procedures, for the taxes paid abroad.

(b) Dividends from foreign subsidiaries of resident corporations

While Belgium exempts up to 90 or 95 per cent of the foreign dividends derived from permanent participations held by Belgium-based corporations, the tax legislation of many other States contain provisions having comparable effects. Let us mention, again by way of example:

- exemption of up to 50 per cent of such dividends;
- complete exemption;
- tax credit not only for the foreign taxes on dividends as such but also for the taxes paid by the foreign subsidiary in respect of the profits out of which the dividends were paid.

to this last system of "full credit" applied in the United States in particular, it will be noted with interest that it generally results in the total exemption of the dividends derived from foreign subsidiaries, which makes the criticism of Belgium by the United States surprising, to say the least, when it is known that this system of tax credit is being applied in that country.

In conclusion, Belgium is of the opinion that if the provisions of its legislation aimed at relief from the double taxation of income from foreign branches and subsidiaries - which, be it noted, are also applied to other types of foreign income - were to be found to be incompatible with the provision in Article XVI:4 of the GATT, the similar measures taken by many other contracting parties would also be put in question; in particular, the United States legislation concerning the foreign tax credit would also have to be condemned.

The Belgian Government fails to see, however, in what way the provisions for the avoidance of double taxation contained in the legislation of most countries would be contrary to the provisions of the General Agreement, and it strongly hopes that the Council will be able to share that opinion.

If, to suppose the impossible, that were not be so, the question may rightly be asked whether the conclusion of bilateral agreements for the avoidance of double taxation confirming or expanding unilateral measures of relief from double taxation should not also be found contrary to the provisions of the General Agreement.

Mr. Chairman, I do not want to take up any more of the Council's time. Allow me, however, to emphasize once again the highly authoritative opinion of the International Chamber of Commerce circulated by the GATT secretariat on 3 June last (L/4505). The observations expressed by the Commission on Taxation of that organization reflect and even reinforce, if that were necessary, the considerations which I have had the honour of presenting to the Council.

In conclusion, Mr. Chairman, the Belgian delegation wishes to reaffirm the importance it attaches to the "arm's length" principle in the application of its tax legislation; and in its desire to apply the rules and procedures of the General Agreement, my delegation requests you, Mr. Chairman, to make every effort to elicit a reply to the question on the concept of "export activities" within the meaning of the General Agreement, even if this were to require the devising of a new and pragmatic solution in the context of respect for the principles of settlement of disputes.

I request that my statement be published in the manner that you may judge most appropriate and I thank you, Mr. Chairman, for the kind attention with which you and the Council have listened to this statement.