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Hong Kong's International Gateway: Belgium

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Asia - Pacific Tax Bulletin,
March / April 3005, p.210

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1. INTRODUCTION

On 10 December 2003, Belgium and Hong Kong entered into a double taxation agreement with respect to taxes on income and capital (together with the Protocol to the DTA, the "DTA"). The DTA is the first comprehensive income tax treaty ever concluded by Hong Kong[1] and therefore, signifies an important milestone. Aside from the DTA's "first in its kind" status, it provides substantial benefits to Hong Kong investors as well as others who wish to invest through Hong Kong based companies.

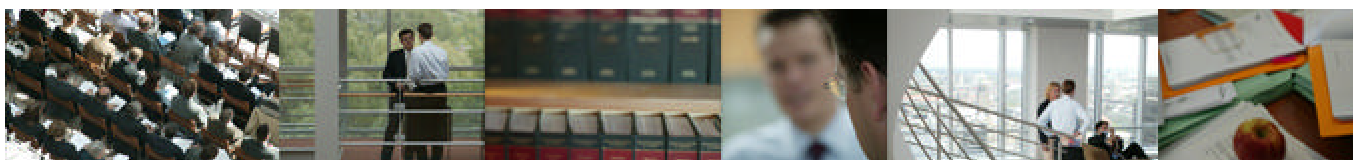
The DTA entered into force with retroactive effect on 7 October 2004, and applies:
– in Hong Kong, for any year of assessment beginning on or after 1 April 2004;
– in Belgium:
– in respect of taxes due at source, on income credited or payable on or after 1 January 2004;
– in respect of other taxes charged, on income of taxable periods beginning on or after 1 January 2004;and
– in respect of taxes on capital charged, on elements of capital on or after 1 January 2004.

A number of salient aspects of the DTA are discussed in this article.

2. SOME SPECIFIC DTA FEATURES AND OPPORTUNITIES

2.1. Personal scope of the DTA

The DTA applies to "persons" that qualify as "residents of a contracting party", as is generally the case with DTAs concluded by Belgium. Contrary to most other DTAs, the term "person" also applies to Hong Kong estates, trusts and partnerships (besides individuals, companies and any other body of persons). However, a person can only benefit from the DTA if the person can be considered a "resident" for DTA purposes, i.e. if the person is liable to tax in its country of residence. In this context, the Protocol to the DTA additionally specifies that when a person has been constituted under the laws in force in Hong Kong or if it has been constituted outside Hong Kong but has its central management and control in Hong Kong, this person also qualifies as a "resident of a contracting party". The Protocol furthermore states that the application of a territorial source principle in the



taxation system of a contracting party (like Hong Kong) does not preclude a person from being treated as "resident of a contracting party".

Because Hong Kong persons are taxed on the basis of a territorial source principle (onshore sourced income or profits being taxable, whereas offshore sourced income or profits being non-taxable), the DTA explicitly confirms that these persons can rely on the DTA and its benefits.

2.2. Definition of permanent establishment

A permanent establishment (PE) is defined in accordance with the terms of the United Nations (UN) Model Convention instead of the Organisation for Economic Co-operation and Development (OECD) Model Convention. Hence, the DTA provides that a PE arises if, among others:

– a building site or a construction, assembly, installation or dredging project exists for more than six months in any 12-month period;

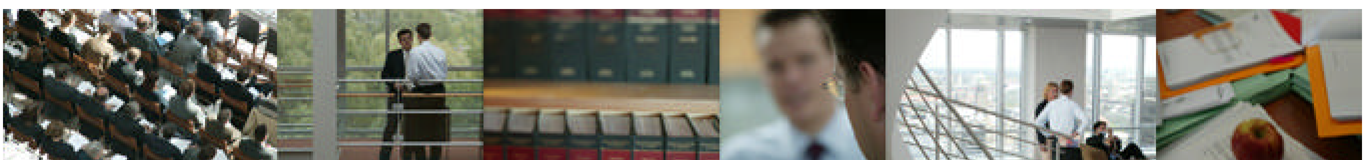
– supervisory activeities are carried out for more than six months in any 12-month period in connection with a building site, or a construction, assembly, installation or dredging project;

– services, including consultancy services, are furnished through employees or other personnel engaged by an enterprise for such purpose for a period or periods aggregating more than six months within any 12-month period; and

– a stock of goods or merchandise belonging to an enterprise of a contracting state for which a person acts on behalf of and habitually fills orders in the other contracting state is maintained in that other contracting state.

On the basis of the DTA definition of a PE, Hong Kong enterprises can now appoint Belgian sales agents without these agents constituting a taxable presence for the Hong Kong enterprise in Belgium (and vice versa). A typical example would be a Belgian agent, with an independent status and acting in the ordinary course of his business, selling goods of the Hong Kong enterprise/principal to third party customers in its own name but for the account of the Hong Kong enterprise/principal. While all property rights to the goods pass immediately from the Hong Kong enterprise/principal to third party customers, no contractual relationship exists between the Hong Kong principal and these customers. The Belgian commission agent's taxable income consists of the arm's length commission fee received.

The DTA therefore, provides a shelter against tax for certain agency operations as well as projects or presences carried out in the other jurisdiction.



2.3. Investment income

2.3.1. Investments in equity-instruments: Belgian holding companies

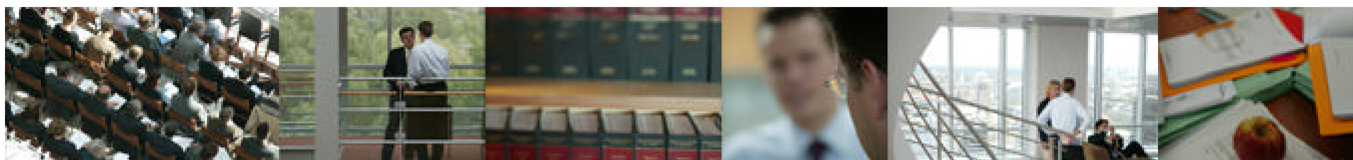
The Belgian government's press release on the DTA refers to interesting Belgian fiscal opportunities that become accessible to foreign investors in Belgium by virtue of the DTA. Probably one of the most interesting aspects of the DTA is that it offers Hong Kong companies the possibility to use Belgium as their overseas holding company jurisdiction, as it enables a Belgian company to distribute its income free of withholding tax to its Hong Kong parent compan(y)(ies). Coupled with Belgium's tax regime for investment holding activities, which, under conditions, enable the Belgian company to earn foreign dividends and capital gains effectively free of income tax, Belgium has placed itself in the top of the shortlist of Hong Kong (and other) investors.

2.3.2. Belgian holding company regime

A Belgian company subject to the standard Belgian corporate income tax regime is in principle taxable on its overall net taxable income, distributed dividends included, as determined following Belgian accounting principles. The current income tax rate is 33.99%.

Dividend income received is, however, eligible for a 95% exemption in the hands of the Belgian company. The remaining 5% is subject to the 33.99% corporate income tax to the extent that it has not been offset against taxdeductible costs incurred by the Belgian company. For the 95% exemption to apply, it is required that:

– the Belgian company holds a participation (i) of at least 10% of the distributing subsidiary's nominal share capital or, alternatively (ii) with an historic acquisition price of at least EUR 1.2 million;
– at the time of the dividend distribution, the Belgian company has fully owned (or commits itself to do so) the subsidiary's shares for a period of at least 12 months;
– the subsidiary's shares qualify and are recorded in the Belgian company's books as "fixed financial assets"; and
– the subsidiary (as well as any lower tier subsidiary) meets the so-called "subject-to-tax requirement". In general, the "subject-to-tax requirement" is met if the subsidiary and any lower tier subsidiary:
– is resident for tax purposes in a country the normal tax regime of which is not substantially more advantageous than the standard Belgian tax regime;**2**
– is subject to a foreign tax similar to Belgian corporate income tax (i.e. a tax on profits);
– does not qualify as a finance company, a treasury company, or an investment company which benefits from a special tax regime in its country of fiscal residency;
– does not qualify as a so-called offshore entity, implying that it should not receive foreign source income other than dividends which is subject in its country of residence to a separate tax regime deviating from the standard



tax regime; and

– does not realize profits through foreign branches which on consolidated basis are subject to a tax assessment regime that is substantially more advantageous than the Belgian one.[3,4]

On 23 April 2004, a Belgian Court of First Instance held that a Belgian company should be able to benefit from the 95% exemption with respect to dividend income originating from a Hong Kong subsidiary because it considered the standard Hong Kong tax regime not to qualify as substantially more advantageous than the standard Belgian tax regime.[5]

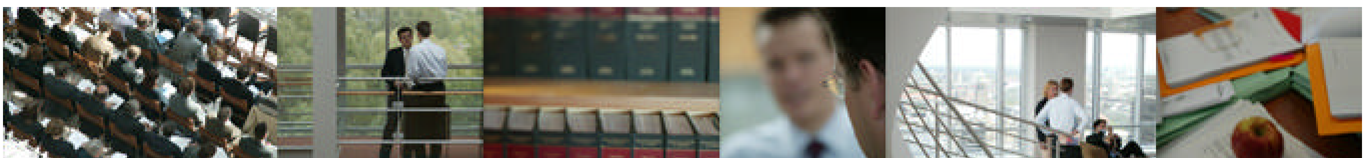
Capital gains obtained by a Belgian company through the sale of shares of a subsidiary company are fully exempt from the 33.99% Belgian corporate income tax, provided the aforementioned “subject-to-tax requirement” is met. No other conditions apply thus making a Belgian holding company a very suitable vehicle also for relatively smaller investments with high short-term capital gain potential. If the realization results in a capital loss, the company will not be able to deduct the loss (with the exception of, to a certain extent, capital losses realized on the liquidation of the underlying subsidiary).

If properly implemented, the Belgian company will be allowed to claim a tax deduction for any interest expenses incurred under loans provided to the company, in order to finance the purchase of the overseas subsidiaries. In this way, the 5% taxable income under the Belgian participation exemption explained above could be reduced through the interest deduction.

2.3.3. Belgium as an international holding company location

In order to maximize the tax efficiency of a holding structure, the foreign investor wants to minimize any overseas taxes on its worldwide profits. Care should therefore be taken that any dividends or capital gains on share disposals would not be subject to an adverse dividend withholding tax or capital gains tax in the hands of the operating subsidiaries worldwide.

Belgium also offers interesting tax saving opportunities, as no such foreign dividend withholding tax or capital gains tax should be levied at the subsidiary level, if the Belgian holding company operates as ultimate holding company of a multinational group’s European subsidiaries. In such case, the application of the European Union Parent-Subsidiary Directive prevents EU Member States from levying dividend withholding tax on dividends distributed by a qualifying resident subsidiary to a Belgian holding company if the latter has a minimum holding of 25% in the capital[6] (or voting rights) of the aforementioned subsidiary and if it maintains such minimum holding for an uninterrupted period of at least two years (which is a maximum period).



For non-EU subsidiaries, one would want to rely on a strong network of DTAs. For dividends that non-EU subsidiaries distribute to Belgian holding companies, Belgium's DTAs often lower the maximum dividend withholding tax that can be levied by the foreign state to 15%, 10% or even 5%.

If a Belgian holding company realizes a capital gain on its foreign subsidiary shares, such capital gain is generally not subject to tax in the state in which the subsidiary is a tax resident. This follows from the application of DTAs, which normally stipulate that capital gains may only be taxed in the state of which the alienator is a resident (in this case, Belgium). See for example the Belgium–Mexico, Belgium–Australia and Belgium–South Korea DTAs. The DTA follows the general principles as described in the previous paragraph. The DTA stipulate that the contracting state in which the immovable property or the PE is situated, is entitled to tax the capital gains, only if the alienated asset qualifies, in general, as:

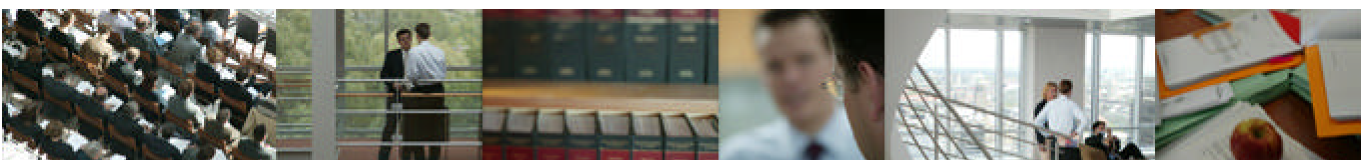
– immovable property situated in the other contracting state;
– movable property allocated to a PE in the other contracting state; or
– shares of a company more than 50% of the value of which is derived directly or indirectly from immovable property situated in the other contracting state (some exceptions apply for listed companies, reorganizations, etc.).

2.3.4. Belgian withholding tax on dividends distributed to Hong Kong parent companies

Under Belgian domestic tax law, a 25% dividend withholding tax has to be deducted from the gross amount of dividend distributions unless reduced under a DTA or under the EU Parent-Subsidiary Directive. In the case at hand, the DTA stipulates that Belgian withholding tax on dividend distributions to beneficial owners resident in Hong Kong may not exceed:

– 0% if the beneficial owner of the dividends is a Hong Kong company which at the moment of the payment of the dividends holds, for an uninterrupted period of 12 months, shares representing directly at least 25% of the capital of the Belgian company paying the dividends;
– 5% of the gross amount of the dividends if the beneficial owner is a Hong Kong company which holds directly at least 10% of the capital of the Belgian company paying the dividends; or
– 15% of the gross amount of the dividends in all other cases.

Consequently, a Hong Kong company investing overseas through a Belgian holding company can channel the dividends earned through the Belgian company without any Belgian income tax or dividend withholding tax,



whilst benefiting from the reduced dividend withholding tax rates in the countries of its subsidiaries.

2.3.5. Investments in debt instruments: interest

Under Belgian domestic tax law, interest paid to overseas lenders is in principle subject to 15% withholding tax. The DTA stipulates that withholding tax on interest payments from one contracting state to beneficial owners that are resident in the other contracting state may not exceed 10% of the gross amount of the interest, although a full exemption from withholding tax applies to:

– interest on commercial debt claims (including debt claims represented by commercial paper) resulting from deferred payments for goods, merchandise or services supplied by an enterprise;
– interest paid in respect of a loan granted, guaranteed or insured or credit extended, guaranteed or insured under a scheme organized by a contracting state or one of its political subdivisions or local authorities in order to promote the export;
– interest on debt claims or loans of any nature (not represented by bearer instruments) paid to banking enterprises;
– interest on deposits made by an enterprise with a banking enterprise; and,
– interest paid to the other contracting state or one of its political subdivisions or local authorities.

3. SPECIAL PROVISIONS

3.1. Exchange of information

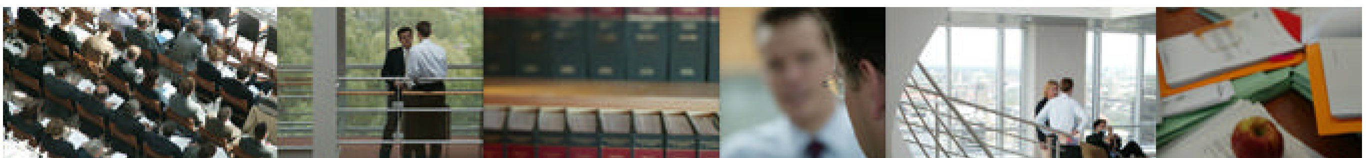
The DTA provides for an exchange of information that is in line with the 1998 OECD Model Convention, implying that such an exchange can only relate to taxes covered by the DTA (as identified in Art. 2 of the DTA).

3.2. Limitation on benefits

The DTA does not contain a specific “limitation on benefits provision”. Thus, non-Belgian or non-Hong Kong residents may indirectly take advantage of the DTA benefits by investing through a qualifying Hong Kong or Belgian resident.

4. THE GREATER PERSPECTIVE

As may follow from the above, the DTA contains a number of unique features that enable Hong Kong investors to structure their overseas investments through a Belgian holding company, so as to minimize the overseas income and withholding tax on their overseas earnings. However, the scope is not confined to investors who have their home base in Hong Kong. It could also be utilized by investors from other countries, which do not currently have an advantageous DTA network or who wish to benefit from Belgium’s strategic location in Europe



in general and the European Union in particular. For example, within Asia, investors based in Brunei, China, Malaysia, the Philippines, Taiwan and Thailand may stand to gain by structuring their international investments through a Hong Kong/Belgian company.

Outside Asia, we believe that the DTA offers interesting opportunities to investors from a number of South American countries. Under circumstances, even within the European Union, especially for individual investors, the DTA offers excellent tax planning opportunities, as it gives the investors an opportunity to combine the benefits of a tax efficient holding structure with the avoidance of dividend withholding tax (the latter which in most EU countries they would otherwise suffer on their dividend earnings).

Footnotes

1. Hong Kong entered into a DTA with China in 1998, but the scope of that DTA is limited.
2. A tax regime is deemed to be substantially more advantageous if the standard nominal corporate income tax rate is lower than 15% or if the effective tax burden is lower than 15%. The standard tax regimes of all EU countries are deemed not to be substantially more advantageous than the Belgian one.
3. However, if the global effective tax burden of the profits originating from the foreign branch amounts to at least 15%, or if the company and its foreign branch are located within the European Union, this exclusion does not apply.
4. Should one or more of these conditions not be met, a meticulous analysis of the subsidiary and any lower tier subsidiaries and branches should be carried out in order to determine whether or not the participation exemption may nevertheless apply.
5. The Court explicitly referred to the DTA in reaching that conclusion. The exact implications of the court case are not entirely clear as the applicable tax code provisions were slightly amended in 2002 and the Court did not discuss all of the above listed anti-abuse provisions.
6. The 25% threshold will be lowered to 20% as of 2005, to 15% as of 2007 and to 10% as of 2009.