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# Notional interest deduction

## What NID could mean for your company's effective tax rate

Notional interest deduction - concept

The deduction for risk capital or more commonly called "notional interest deduction" (NID) is a unique tax measure allowing a tax-free return on qualified equity by allowing a deemed interest deduction calculated as the qualifying equity multiplied by the applicable NID rate.

The measure was introduced in 2005 (applicable as from tax year 2007) and in principle applies to all companies with a Belgian taxable presence, irrespective of their size, industry or activities. This reflects the broad objective of the measure, which was to align the tax treatment of financing a company with equity with the tax treatment of financing with debt in order to allow companies to strengthen their capital structure without giving up the benefit of tax-deductible interest payments.

Consequently, the NID may create a tax lowering effect to many companies. In particular for equity intensive activities (e.g., group financing, intellectual property, etc.) this will lead to quite a low effective tax rate.

Field of application

#### Eligible companies

All companies (Belgian or foreign) which are subject to (i) Belgian corporate income tax, or (ii) Belgian non-resident corporate income tax (i.e. permanent establishment, Belgian real estate income) are eligible for NID.

Companies that benefit from another Belgian beneficial tax regime are excluded from the application of the NID, i.e.

- ▶ Belgian Recognized Coordination Centers
- ▶ Reconversion companies
- ▶ Investment companies (Beveks / Sicavs)
- ▶ Certain cooperative participation companies
- ▶ Shipping companies applying the tonnage tax regime

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# The notional interest deduction, a unique tax measure.

### Eligible income

There is no restriction on the type of income against which the NID can be set off. So, all business income will be eligible, e.g. operational income, interest, dividends, royalties, etc.

Certain anti-abuse rules limit the use of NID to set off non-arm's length profit, so-called received abnormal or gratuitous benefits.

### How does it work?

An off-balance tax deduction is obtained by applying the annually set NID rate on the Qualifying Equity. The resulting amount is deducted from the taxable base remaining after the application of the patent income deduction and the participation exemption on capital gains on shares and dividends and prior to deducting the tax losses carried forward.

This is a notional interest deduction for which no cash payment occurs or interest expense is booked.

If the calculated NID in a particular year exceeds the taxable income, the excess NID can be carried forward for seven years.

### Qualified equity

The Qualified Equity is determined as the total equity stated in the non consolidated Belgian Statutory closing balance sheet of the previous taxable period adjusted with a number of items to avoid artificial boosts of Qualifying Equity and duplication of tax benefits.

The equity according to Belgian statutory accounts includes the paid-up capital, share premium, unrealized revaluation gains, reserves, retained earnings and losses and capital subsidies. The following items, as determined per the end of the previous taxable period are to be deducted from this accounting equity:

- ▶ The fiscal net value of own shares and other shares recorded as financial fixed assets
- ▶ The fiscal net value of shares issued by investment companies of which the income would qualify for the Belgian Participation Exemption

- ▶ The net equity value allocated to foreign permanent establishments or foreign real estate properties or rights of which the income would qualify for an exemption based on a double tax treaty
- ▶ The net book value of tangible fixed assets that unreasonably exceed professional needs
- ▶ The book value of tangible fixed assets that are held as investment assets and can by their nature not generate periodic income
- ▶ The book value of real estate assets or rights used by the directors, their spouse or children
- ▶ The tax exempt portion of revaluation gains, capital subsidies and tax credits for research and development

Both upward and downward changes of the different components of the Qualifying Equity over the taxable period are taken into account on a pro-rata monthly basis, except for the changes in the current year income.

### The rate

The base NID rate for any particular tax year is fixed annually and is determined as the monthly average interest rate for risk-free, long-term government bonds (the ten-year OLO) over the calendar year two years prior to the tax year at hand. As an example, note that in Belgium tax year 2012 relates to financial years closing between 31 December 2011 and 30 December 2012. Closing per 31 December 2011 is tax year 2012. Closing per 30 December 2011 is tax year 2011.

The annual NID rate increase or decrease is currently however capped at 1%, while the maximum base rate is capped at 6.5% (temporary capped for tax years 2011 and 2012 at 3.8%).

For small and medium size entities ("SME"), the base rate is increased with 0.5%.

|               | Non SME | SME    |
|---------------|---------|--------|
| Tax year 2009 | 4.307%  | 4.807% |
| Tax year 2010 | 4.473%  | 4.973% |
| Tax year 2011 | 3.8%    | 4.3%   |
| Tax year 2012 | 3.425%  | 3.925% |

### Overview of the applicable rates Impact on effective tax rate

Example illustrating the ETR on a Belgian company in any business (1,000 business assets / 1,000 q. equity) (tax year 2012) (ETR = effective tax rate)

| Return on equity | ETR before NID | ETR after NID |
|------------------|----------------|---------------|
| 3.425%           | 33.99%         | 0%            |
| 4%               | 33.99%         | 4.9%          |
| 5%               | 33.99%         | 10.7%         |
| 6%               | 33.99%         | 14.6%         |
| 8%               | 33.99%         | 19.4%         |
| 10%              | 33.99%         | 22.3%         |
| 15%              | 33.99%         | 26.2%         |

### Formalities

- ▶ The NID is automatically applicable. However, a form has to be filed with the tax return calculating the claimed NID
- ▶ The application of the NID is not subject to any investment or employment obligation or approval by the Belgian tax authorities through a formal or informal ruling
- ▶ Companies are allowed to deny (part of) the application of the NID, which is particularly relevant for companies part of a group to which strict CFC regulations apply if the effective tax rate of the Belgian company drops below a certain percentage

### Explanatory notes

Explanatory Notes were issued by the Belgian tax authorities in the Circular Letters dealing with the possible abuse of the NID regime. These Notes mainly summarize the existing NID specific and general anti-abuse legislation and administrative viewpoints by highlighting applicable case law and published rulings on the application of the NID.

No new technical positions are taken in these Circular Letters. The publication of the Letters emphasizes that the tax authorities will scrutinize artificial and pure tax driven transactions on the basis of the existing anti-abuse legislation.

However at the same time and more importantly, the Notes provide comfort on a number of important principles; e.g. confirmation of the use of NID for former BCCs which continue their activities in Belgium within the same legal entity or within another group entity in Belgium and use of NID for Special Purpose Vehicle centralizing financing or other activities.

### Belgian ruling practice

The Belgian ruling commission has already issued various rulings tackling interpretation issues on the application of the NID providing guidance on an important number of initially unclear or uncertain aspects of the application of the Notional Interest Deduction.

### Factors increasing the benefit of the NID

- ▶ No capital duties, allowing increases in share capital in cash or in kind without tax leakage
- ▶ Domestic exemption of withholding tax on dividends to Qualifying Parent Companies located in treaty countries allowing tax-efficient profit repatriation
- ▶ Introduction of the Patent Income Deduction as from tax year 2008 (see our separate flyer)
- ▶ Broad and strong treaty network (approx. 98 treaties), in particular very beneficial treaty with the US
- ▶ Excellent tax regime for expatriates
- ▶ Business minded Belgian ruling practice
- ▶ Foreign tax credit system on interest and royalties

### Overall benefit

The introduction of the NID has, besides enabling Belgian companies and Belgian Permanent Establishment to lower the effective tax rate, created a number of opportunities for foreign companies/groups to make and carry out capital intensive investments and activities in Belgium.