

## BELGIUM

## SAFE HARBOUR RULINGS FOR BELGIAN SERVICE CENTRES

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## I. INTRODUCTION

Although Belgium has a relatively high corporate income tax rate (39 per cent plus 3 per cent crisis contribution, i.e. 40.17 per cent), it has over the past 15 years successfully developed a number of tax incentives to compete with its neighbouring countries in the race to attract investment from multinational enterprises.

The principal examples of this Belgian tax policy<sup>1</sup> are the adoption of the Belgian coordination legislation<sup>2</sup> and the Belgian distribution centres tax circular.<sup>3</sup>

*Coordination centres* must apply to the Belgian Government for recognition. They can only be established by large multinational groups which meet certain criteria.<sup>4</sup> Banks, financial institutions and insurance companies are not allowed to set up a coordination centre. The activities of a coordination centre must remain limited to those specifically included in its recognition decree. However, the permissible activities cover a wide variety of intra-group financial services, headquarters-type coordination and back office support functions.

Coordination centres are subject to the regular corporate income tax at the normal rate. However, their taxable basis is not their actual income but a notional income. That notional income is determined as a percentage (usually 8 to 10 per cent) of the centre's operational costs other than payroll expenses and financial charges. The average taxable basis of operating coordination centres was 3.34 per cent and 2.19 per cent, respectively, of their fiscal year profit in 1990 and 1991. Coordination centres also benefit from certain other tax exemptions such as the exemption from withholding tax on interest and dividends paid by coordination centres to banks and other companies.

The main drawbacks of the coordination centre regime are the requirement to engage ten full-time employees within two years from the start of their activities and the fact that they can only be established by truly large international groups.

Coordination centres have been successfully set up by numerous multinational groups, a large majority of which are US controlled. Since 1983, more than 350 coordination centres have been recognized of which more than 250 are currently operational, mainly as group finance centres.

In 1989, the Belgian tax authorities issued a circular modelled after the Dutch regime applicable to *distribution centres*. Under the circular, Belgian distribution centres remain subject to the ordinary corporate income tax regime but the

transfer prices applied between the distribution centre and other affiliated companies benefit from a safe harbour. The safe harbour implies that the tax authorities will not challenge the inter-company prices of the distribution centre provided the distribution centre's turnover is at least equal to 105 per cent of its operational expenses. Initially, the distribution centre regime applied only if the centre's activities were limited to the storage and handling of raw materials or inventories for the benefit of affiliated companies. In addition, the tax base for the calculation of the safe harbour was not clearly defined. In an effort to rectify these perceived flaws first an amended circular and then a new circular expanded the range of permissible activities and defined more accurately "operational expenses". This "clarification" has led to distribution centres being set up by several leading multinational groups.

More recently, a circular dated 26 July 1996 introduced a new *service centre regime* similar to the distribution centre regime. Essentially, it provides for a safe harbour with respect to transfer prices between the service centre and other affiliated companies. The range of permissible activities is similar to permissible coordination centre activities. The service centre regime may attract groups which either do not meet the requirements for establishing a recognized coordination centre or do not wish to establish a coordination centre because, for example, the ten-employee requirement or home-country legislation makes it unattractive to have a coordination centre. More importantly, however, the new service centre regime should interest multinational groups that are per se interested in a safe harbour with respect to the transfer pricing applied between their (regional) service support centre and affiliated companies.

Inspired by the Dutch ruling practice, the 1996 circular draws flexible guidelines for negotiations with the tax authorities on the conditions of operation of the service centre. It rests with the group to describe its business, goals and the expected

1. Other tax incentives have been granted to enterprises on the basis of their location (enterprises established in the so-called *employment zones*, *T-zones* or *reconversion zones*) or on the basis of their activities (*innovation companies* carrying out highly innovative technological processes).

2. Royal Decree No. 187 of 30 December 1982 relating to the creation of coordination centres, as amended, and implementing legislation.

3. Circular of 30 November 1996 relating to distribution centres

4. The group (companies under common control and linked by a 20 per cent shareholding) must have an annual consolidated turnover of BEF 10 billion and a consolidated equity of BEF 1 billion; in addition, the group must have four affiliated companies in four different countries, and realize a consolidated turnover of BEF 5 billion or 20 per cent of its worldwide turnover and have a consolidated equity of BEF 500 million or 20 per cent of its worldwide equity outside the home country of the parent company.

development in the levels of employment. Subsequent to negotiations with the group, the tax authorities can decide on the specific permissible activities of the service centre and on the minimum profit margin it is expected to realize. In other words, service centres are allowed to set their inter-company prices at such a level that the book profit equals the negotiated cost-plus. Obviously, the goal of any group will be to set as low a price as permitted, and consequently reduce their taxable profit down to the negotiated mark-up, since the ruling protects them from inter-company price adjustments.

Hereafter follows a more detailed description of the service centre regime.

## II. TERMS AND CONDITIONS

### A. Qualifying entities

A service centre can be established either as a Belgian company or as a separate Belgian branch of a foreign company. It must belong to a group.<sup>5</sup>

The group is defined by reference to the definition of affiliated companies in the annex to the Royal Decree of 8 October 1976<sup>6</sup> relating to the annual accounts of enterprises.<sup>7</sup> A company is affiliated to another when it controls the other company, it is controlled by the other company, or both companies are subject to a common control. For the purpose of this definition, control is the legal or actual power to exercise a significant influence on (i) the appointment of the majority of the company's directors or managers, or (ii) the management policy of the company. A company holding more than 50 per cent of the voting rights in a subsidiary is irrefutably presumed to control that subsidiary.

If one decides to establish a service centre as a branch, and the service centre only renders auxiliary and preparatory services for the benefit of the company of which it is part, it probably will not constitute a permanent establishment in Belgium under the applicable double tax treaty provision (Article 5, paragraph 4, of the OECD Model Tax Treaty). In such case, one must bear in mind that the service centre may be totally exempt from Belgian income tax and the application for a service centre ruling would not serve any purpose.

### B. Permissible activities

The common feature of the permissible service centre activities is their administrative nature. A service centre is not allowed to carry out marketing or manufacturing activities. At first sight, permissible service centre activities are akin to coordination centre activities. However, the definition of service centre activities is more flexible, since service centres are allowed, to a certain extent, to have contacts in their own name with group members' customers. In addition, a service centre's permissible activities are negotiated with the tax authorities on a case-by-case basis. These activities must fall into one of the following four categories:<sup>8</sup>

#### 1. Preparatory and auxiliary activities

The terms "preparatory and auxiliary activities" are defined by reference to Article 5, paragraphs 4(d)&(e) of the OECD Model Tax Treaty.

The service centre cannot carry out activities which constitute or are part of the group's core business. In addition, these activities must not, in principle, contribute any added value to the goods or services supplied by the group.

Permissible activities include, for example: maintaining a data bank of travel-miles for an airline group; management of internal (between group members) or external communication flows, exclusive of commercial contacts; central purchasing for the account of group members; and scientific research of a preparatory or auxiliary nature.

#### 2. Information to customers

This category includes support services to a group's customers, such as computer help lines and information on goods and services supplied by group members.

#### 3. Passive sales-related activities

A service centre cannot bear any business risk. It acts *in the name and on behalf* of the group members in the capacity of a passive agent. It cannot negotiate or accept orders from the customers but it can collect and confirm orders in the name of group members.

#### 4. Active sales-related activities

A service centre may be allowed to act in its *own name but for the account* of their group members. The business risk that it bears must however remain minimal. In order to ensure that this requirement will be satisfied, the tax authorities require the applicant to submit the draft agreements under which the centre is expected to operate.

The terms and conditions of any servicing, or supplying of goods to customers must be directly negotiated between the customers and group members. A service centre cannot promote the goods or services supplied by group members. An example of an activity that would qualify under this heading is re-invoicing.

This fourth category of permissible activities distinguishes service centres from coordination centres since coordination centres are not allowed to contact non-group members in their own name.

### C. Intra muros

A service centre's services are designed to be for the exclusive benefit of the members of its group. A service centre

5. It can only operate for the benefit of group members (see below).
6. Chapter III, Sec. 1, item IV. A.
7. Service centres may be the alternative solution for groups which intend to set up their regional headquarters in Belgium but which do not satisfy the multinational test for the purposes of coordination centre legislation (see above).
8. These categories appear to overlap each other somewhat.

cannot supply information or assistance to customers of a non-group member.

The intra-muros requirement is not applicable to the supplies provided to the service centres. A service centre can freely buy the goods and services it needs to carry out its activities. In this context, it is worth noting that the intra muros rule does not preclude the service centre from acting as a central purchaser for the group since it buys for the benefit of group members.

#### D. Recognition

A service centre must be officially recognized as such before it can benefit from the special tax regime. Rulings stating the permissible activities and the applicable mark-up (see below) are obtained through negotiations with the tax authorities.

Requests must be filed with the Central Administration of Direct Taxes. Applicants must include all information regarding the seat, the nature of the purported activities, the nature and the extent of the risks borne by the service centre, and a copy of the agreements between the service centre and the group members.

Requests in French must be mailed to:

Administration centrale des contributions directes  
Direction II/2  
Tour des Finances  
Boulevard du Jardin Botanique 50, bte 32  
1010 Bruxelles

Requests in Dutch must be mailed to:

Hoofdbestuur der directe belastingen  
Directie II/1  
Financietoren  
Kruidtuinlaan 50, bus 32  
1010 Brussel

The request must be filed before the establishment of the service centre if the service centre is to qualify from commencement. Existing entities may also apply for the ruling regime. In such case, the request must be filed prior to the first fiscal year to which the ruling applies.

### III. SCOPE OF THE SAFE HARBOUR RULING

#### A. Service centres are subject to the regular corporate income tax rules

The taxable basis of a service centre is determined according to the regular corporate income tax rules. It includes the service centre's retained earnings, disallowed expenses and dividend distributions, less tax exempt items and carried over losses. The regular tax rates apply (i.e. 40.17 per cent in most cases).

Service centres are also subject to regular transfer pricing rules. Any abnormal or gratuitous advantage granted by the service centre to another enterprise is added to its taxable income.

#### B. Safe harbour

The 1996 circular provides service centres with a safe harbour: the tax authorities will consider that a service centre has not granted any abnormal or gratuitous advantages to its group members provided that the service centre realizes a book turnover corresponding, at a minimum, to the notional amount calculated according to the circular and set forth in the ruling. Should a service centre's book turnover be, however, less than the notional minimum turnover, the difference will be deemed to be an abnormal and gratuitous advantage granted to its group members and will be added to its taxable basis.

#### C. Cost-plus and resale-minus ruling

The safe harbour must be negotiated with the tax authorities based upon the following principles:

##### 1. Preparatory and auxiliary activities; customer information; passive sales-related activities: cost-plus

When a service centre's activities do not include any active intermediary role in the sales or services provided by group members, the compensation for its services must be at least equal to its operational costs relating to its activities increased with a certain mark-up.

The mark-up is agreed to by the tax authorities on a case-by-case basis, depending on the type and volume of the activities actually carried out. The circular provides a list of indicative mark-ups:

a. Preparatory and auxiliary activities:	5%
b. Customer information:	10%
c. Passive sales-related activities:	15%

Operational expenses include the costs booked to accounts 60 to 64 of the Belgian Minimum Standard Chart of Accounts (i.e. consumable goods, services and other goods, payroll expenses, depreciation, write-offs, provisions for liabilities and charges, other operating charges). They do not include the turnover of group companies flowing through the service centre, expenses whose deduction is not allowed for tax purposes, and taxable reserves.

The tax authorities may agree that payroll expenses and third party charges can be charged back with a zero mark-up. Personnel expenses include all costs related to personnel. Costs of services supplied by third parties to the service centre qualify if they could have been billed as such directly to group members and provided they are billed by the supplier with a normal profit margin.

## 2. Active sales-related activities: resale minus

When a service centre acts in its own name and for the account of the group members, the minimum compensation is determined as the profit that a service centre should make on its total sales.

The turnover cannot be less than the aggregate costs booked to accounts 60 to 64 of the Belgian Minimum Standard Chart of Accounts (including personnel expenses), excluding disallowed expenses and items included in taxable reserves.

The profit margin is determined on a case-by-case basis and should not exceed 5 per cent.

Service centres carrying out different types of activities must allocate the costs to each activity before applying the proper computational method.

## IV. DURATION OF THE SAFE HARBOUR RULING

Although not clearly stated in the 1996 circular, the regime applies as from the date of establishment of the service centre if the request has been filed prior thereto, or as from the

beginning of the first fiscal year commencing after the filing of the request.

The regime applies for five years unless the service centre expands its activities beyond the tax authorities' recognition. The circular does not specify when the regime actually terminates if the end of the fifth year does not coincide with a fiscal year closing date.

## V. CONCLUSION

The safe harbour regime for service centres is attractive in that it provides a multinational group the opportunity to obtain more certainty with respect to its transfer prices for certain service support functions that it wishes to centralize in a service support centre. The central location of Belgium in the EU, its well trained labour force and its excellent infrastructure make it an attractive site for an European service centre.

## Conference diary

For further details of the events listed below please write to the organizers at the addresses indicated.

### JANUARY 1997

European Mergers and Acquisitions – Controlled Foreign Company Legislation, Paris, 24 January 1997 (English):

*Institute of Taxation European Branch, 61 Chandos Place, London WC2N 4HG, Tel.: 44-171-836 3266, Fax: 44-171-836 1457.*

### FEBRUARY 1997

Principles of International Taxation, Amsterdam, 3-7 February 1997 (English):

*International Tax Academy, Sarphatistraat 500, P.O. Box 20237, 1000 HE Amsterdam, Tel.: 31-20-626 7726, Fax: 31-20-620 9397.*

Transfer Pricing, Hyde Park Hotel, London, 5-6 February 1997 (English):

*AIC Conferences Limited, 2nd Floor, 100 Hatton Garden London EC1N 8NX, Tel.: 44-171-242 2324, Fax: 44-171-242 2320.*

### MARCH 1997

Trusts and "Stiftungen", Amsterdam, 6-7 March 1997 (English):

*International Tax Academy, Sarphatistraat 500, P.O. Box 20237, 1000 HE Amsterdam, Tel.: 31-20-626 7726, Fax: 31-20-620 9397.*

### APRIL 1997

International Tax Planning Techniques, Amsterdam, 10-11 April 1997 (English):

*International Tax Academy, Sarphatistraat 500, P.O. Box 20237, 1000 HE Amsterdam, Tel.: 31-20-626 7726, Fax: 31-20-620 9397.*

International Partnerships & Joint Ventures, Vienna, 18 April 1997 (English):

*Institute of Taxation European Branch, 61 Chandos Place, London WC2N 4HG, Tel.: 44-171-836 3266, Fax: 44-171-836 1457.*