Memorandum
New Belgian-Dutch Bilateral Tax Treaty

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*On 21 June 2023, the representatives of Belgium (including its states) and the Netherlands concluded a new bilateral tax treaty (hereinafter: '**the new treaty**'), containing a number of significant changes compared to the treaty entered into in 2001 (hereinafter: '**the current treaty**'). In this newsletter, we will provide you with an overview of the most salient changes, which are likely to be the most relevant in practice. We will mention a couple of other changes in the second part of this newsletter.*

Together with the new treaty, the two countries have concluded two so-called protocols, one of which contains important provisions, which we will discuss as well.

Belgium and the Netherlands are expected to complete the ratification process in the course of 2024, in order for the new treaty to enter into effect on 1 January 2025.

Surprisingly, the new treaty does not include provisions to determine how employees who work from home for an enterprise based in the other state should be taxed. Belgium and the Netherlands are still in negotiations about this issue. It would have been useful if the new treaty provided for it, since employees increasingly work from home (online) across the border on a regular basis. Responding to this trend, a substantial number of European member states have concluded framework agreements whereby employees continue to be subject to the social security rules of the country where the employer is established provided that the employee works less than 50 per cent of their time in their home country.

Most Salient Provisions for the International Tax Practice

Global minimum tax

The first protocol to the new treaty provides for a so-called Subordination Clause, meaning that no provision of the new treaty will mitigate the impact of the worldwide minimum tax (so-called Pillar II). This is rather peculiar because the Dutch Secretary of State had previously announced that the implementation of the worldwide minimum tax in the Netherlands would not require any update of existing tax treaties – let alone the conclusion of new tax treaties. The reference made to the worldwide minimum tax in the first protocol to the new treaty can mean two things: it could mean that even though the implementation in national Dutch tax law is sufficient but for the avoidance of doubt it is also included in new treaties on a going forward basis, or it could mean that the Secretary of State is not so sure after all that the national tax provisions supersede the Dutch tax treaties.

Pillar II is the OECD initiative that is supposed to lead to a global system pursuant to which a minimum corporate income tax rate of 15 percent applies to the cross-border profits of qualifying multinational groups. The European version of Pillar II – Directive (EU) 2022/2523 of 14 December 2022 – must be transposed into national law of the member states by 31 December 2023.

In practice, this means that a qualifying enterprise will not be able to rely on the (new) treaty when the result would be that its corporate income tax rate drops below 15 percent.

Residents to whom the new treaty applies

Hybrid Entities

Unlike the current treaty, Article 1 of the new treaty determines how a resident of Belgium has to deal with income from a Dutch hybrid entity. These are entities that are treated in one jurisdiction as tax transparent and in the other jurisdiction as taxable entities in their own right. The new treaty provides that for purposes of the treaty, income derived from a Dutch hybrid entity is earmarked as income from a Dutch resident. Conversely, for income that is exempt from tax by virtue of the new treaty, the Netherlands will no longer grant an exemption from Dutch tax but only allow a deduction of the Belgian tax from the Dutch tax base (and if no tax is due in Belgium, effectively no deduction will apply in the Netherlands).

The precise scope of this new treaty rule is not fully clear yet. It will probably only apply to situations in which the current treaty does not allow the taxpayer to make use of the reduced withholding tax rates for passive income (dividends, interest or royalties).

Dual Resident Companies

Article 4 of the new treaty (the residence article) has made the transition unchanged. In the event that a corporation has dual residence, i.e. in Belgium and in the Netherlands, the so-called tie breaker rule will kick in. That rule prescribes that for a corporation the place of effective management will ultimately determine where it is tax resident. This is rather surprising as this deviates from the 2017 Model Tax Convention of the OECD, which is the basis for the new treaty. According to the Model Tax Convention, dual resident issues for corporations must be resolved by means of a mutual agreement procedure (or MAP) between the contracting states.

Wealth tax

Article 2 of the new treaty restricts the scope of the treaty. As a result, wealth tax is no longer in scope. The Belgian Annual Tax on Securities Accounts (ATSA) is generally earmarked as a wealth tax. Under the current treaty, only the state of residence can levy wealth tax, meaning that Dutch residents can rely on the treaty to escape the ATSA if they own a qualifying securities account in Belgium. This will no longer be the case under the new treaty. Dutch residents owning a securities account in Belgium with an average value in excess of EUR 1,000,000 per year will, therefore, be subject to the 0.15 per cent ATSA. Be aware that the Belgian government announced that it wanted to double the ATSA rate, but this plan seems unlikely to materialise before the general elections of June 2024.

The fact that wealth tax has been carved out of the scope of the new treaty may also mean that if the Netherlands decides to convert its box 3 income taxation into a wealth tax, this would also cease to be protected by the new treaty. This would leave unanswered the question whether this fate would be shared by the capital gains tax, which is more akin to an income tax. As no successor has been found for the box 3 income taxation, it remains to be seen whether its successor will classify as a wealth tax (no compensation to mitigate double taxation) or, rather, as an income tax (compensation to mitigate double taxation).

Another salient feature of the new treaty is that the Belgian real estate withholding tax – which technically speaking is earmarked as an income tax but has many features of a wealth tax – is now explicitly brought under the protection of the new treaty. The practical effect thereof will likely be clarified when the official commentary to the new treaty will be published.

Finally, the Belgian Complementary Crisis Surcharge no longer falls within the scope of the new treaty, which is probably explained by the repeal of the tax (in 2021 for corporate taxpayers; its repeal has been announced for individual income taxpayers).

Prevention of double taxation – the principal purpose test derived from the multilateral instrument

The Principal Purpose Test (PPT) of the Multilateral Instrument (MLI) adopted by the OECD has been explicitly inserted into the new treaty. In fact, the PPT already applies under the current treaty. This test is designed to prevent that benefits under the treaty are granted that are not in line with the purpose and subject of the treaty. In the event of disagreement among the contracting states, the "catch-all clause" may enter into effect, which may eventually result in mutual agreement negotiations between the contracting states.

From a Dutch perspective, two changes should be highlighted:

(1) A "switchover clause" stipulates that as Belgium exempts income from tax or taxes income at a reduced rate by virtue of the new treaty, the Netherlands is no longer obligated to exempt the same income from tax and may decide to allow a deduction of the Belgian tax – if any – from the taxable basis in the Netherlands.

(2) A specific provision should prevent double taxation for hybrid entities (see above).

From a Belgian perspective, two changes are of relevance:

(1) The "subject-to-tax" clause has been reinforced (see further below);

(2) The municipal surcharge on the federal income tax has been carved out from the new treaty.

The Subject-to-Tax Clause: the End of Double Non-Taxation

At the request of Belgium, the provision on prevention of double taxation for Belgian residents has been modified. Only when Dutch-source income (other than dividends, interest or royalties) earned by a Belgian resident is effectively taxed in the Netherlands, will Belgium be obligated to exempt the same income from tax. The text of this treaty provision had been tightened already in 2001, but Belgian case law – relying on the Sidro doctrine – continued to allow an exemption from Belgian tax for Dutch-source income for which the current treaty grants taxing rights to the Netherlands but which was not effectively taxed in the Netherlands. The future will tell whether the reinforced text of the new treaty will supersede the Sidro doctrine and thus allow Belgium to tax Dutch-source income for which the taxing rights are granted to the Netherlands but which is not effectively taxed there.

Permanent establishment

Article 5 of the new treaty, on permanent establishments, also contains a number of changes compared to the current treaty, in order to make it compliant with the MLI. One of most salient changes is the introduction of an anti-fragmentation clause. Under the new treaty, a taxpayer will no longer be able to avoid having a permanent establishment in the other state by "cutting up" contracts into separate parts. Furthermore, the new treaty contains provisions that will more easily lead to a permanent representative of a taxpayer in the other contracting state. The new treaty also contains provisions to ensure that certain activities, such as activities of a preparatory and auxiliary nature, will give rise to a permanent establishment, even if they are dispersed over several legal entities.

Transfer pricing – corresponding adjustment

The new treaty explicitly provides that when one contracting state makes a transfer pricing adjustment to the taxable base of a permanent establishment of a resident of the other contracting state, then this other state must allow a corresponding adjustment to avoid double taxation. In the event that the other contracting state refuses to allow the corresponding adjustment, the taxpayer will be able to rely on MAP to force the two states to take appropriate action in order to shield the taxpayer from double taxation.

Withholding tax

Under the new treaty, withholding tax rates on dividends and interest are lowered in some instances.

Dividends

Withholding tax on dividends is reduced to zero percent, down from five percent, if the beneficial owner of the dividend is a corporation holding a participation in the distributing corporation of at least ten percent for an uninterrupted period of one year. Caveat: pursuant to Dutch case law, the bar for being considered the beneficial owner of a dividend is relatively high. Due to anti-abuse provisions, the dividend-distributing corporation must corroborate that the interest of more than ten percent is not only held as part of the shareholder's enterprise or business activity, but also that the shareholder is actually directing the Dutch subsidiary. In other words, the mere fact that the (Belgian) corporate shareholder is holding an equity participation in a Dutch subsidiary of at least ten percent does not suffice to warrant the zero rate of dividend withholding tax.

For completeness' sake: if Dutch withholding tax is due on any dividend paid to a Belgian shareholder, Belgium will not allow a tax credit, but only a deduction of the Dutch withholding tax from the taxable base of the shareholder in Belgium.

Interest

Under the current treaty, the source country – usually Belgium – has the right to impose withholding tax at the rate of ten percent on interest that is due to a resident of the other state – usually the Netherlands. This withholding tax is eliminated under the new treaty. Consequently, no credit for Belgian withholding tax on interest will be allowed by the Netherlands.

Limited partners

Under the new treaty, income earned by silent (or limited) partners from their profit share (or shares) in a limited partnership (CV or commanditaire vennootschap in Dutch) that is resident in the other contracting state can be taxed in such other state. If Belgium is the state of residence of the limited partner (or partners), it must exempt the same income, provided it is effectively taxed in the Netherlands.

Dutch director-substantial shareholder

Capital Gains: Exit Tax

Article 13 of the new treaty regarding capital gains provides that Belgium does not have the right to tax any increase in value (realised or unrealised capital gain) of shares on which the Netherlands has imposed a so-called conservatory tax assessment as part of box 2 of its personal income tax system. It should be noted that Belgian tax law does not provide for a broad general capital gains tax on shares for private individual shareholders. Therefore, as tax law in Belgium stands today, this treaty provision will have little relevance for Belgian individual shareholders (only in exceptional circumstances will Belgium impose a capital gains tax on shares, i.e., when the transaction falls outside the scope of the normal management of the shareholder's wealth or assets, which in practice is rarely the case). This provision could become more relevant if and when Belgium were to introduce a generic capital gains tax for private individuals.

Dividends: Exit Tax

The new treaty contains a new mechanism for the taxation of dividends paid to a director-substantial shareholder who emigrates from the Netherlands to Belgium. Limb Paragraph 9 of Article 10 explicitly grants the authority to the Netherlands to tax dividends up to ten years after the shareholder's emigration, even if the Dutch corporation has migrated to Belgium along with the substantial shareholder. According to this provision, the Netherlands can impose this tax on dividends only if an actual tax assessment is outstanding or a so-called conservatory assessment is still outstanding in connection with the increase in value of the shareholding at the time of the emigration. The tax so imposed cannot exceed half of the withholding tax rate on dividends that would apply in the other state (Belgium), i.e., currently 30% x ½ = 15 percent.

Company directors

According to Article 15 of the treaty, the remuneration of a company director who is resident in one contracting state while the company is resident in the other contracting state can only be taxed in the state where the company is resident. If the director earns income for activities other than his board membership (such as compensation for daily management of the company) the taxing rights concerning such other income follow the rules of Article 14 (employment income). This is a significant change from the current treaty, which provides that all income earned by a company director is taxable in the state where the company is tax resident, regardless of where the activities of the director are performed. Under the new treaty, the taxing rights will be divided based on the place where the activities of the director are performed.

Other Relevant Changes

Professors, artists and sportspersons

The current treaty contains specific provisions for professors, artists and sportsmen. These specific provisions are no longer included in the new treaty. The provisions relating to employment income (Article 14), business profits (Article 7), or government functions (Article 17) will apply instead (as the case may be).

Compensatory system for cross-border workers

Under the new treaty, the taxation rules for cross-border workers (residing in one state and working in the other) are amended. Stock option rights granted to cross-border workers will no longer be taken into account when computing the compensation.

Stock option rights are taxed at fundamentally different times in Belgium than they are in the Netherlands. In the Netherlands, stock options will trigger tax at the time of exercise (conversion of the options to shares), whereas in Belgium – in most instances – stock options are taxed at grant. Furthermore, the Netherlands provides for a deferment of the taxable event until the shares are sold.

Pensions

The pensions provision (Article 16 of the new treaty) has not changed from the one included in the current treaty. The so-called efficiency threshold (doelmatigheidsgrens) for Dutch-source pensions has not been adjusted or indexed for inflation either.

Interpretation of the New Treaty – OECD Commentary

In the first protocol to the new treaty, it is agreed that the “dynamic treaty interpretation” will apply. This means that at the time the treaty is applied, one must use the then current OECD Commentary to the Model Tax Convention. Today, the rule is that the Official Commentary as it stood at the time the treaty was concluded (in 2001) must be relied upon (so-called historic or static treaty interpretation). As far as the Netherlands is concerned, the new treaty provision is in line with the Dutch treaty policy, thus superseding a ruling from the Dutch Supreme Court (Hoge Raad) in a landmark case of 14 October 2022.

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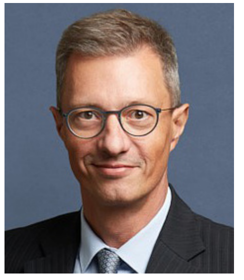

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