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## Notional interest deduction and abolition of capital duty: new boost for investment in Belgium

The law of 22 June 2005 introducing a risk capital deduction (the “notional interest deduction”) was published in the *Belgian Official Gazette* on 30 June 2005<sup>1</sup>.

### A stimulus, in combination with the abolition of the capital duty, to improve the equity capital of companies

The notional interest deduction which is now introduced in Belgian tax law is intended to encourage the strengthening of companies’ equity capital by narrowing the discrimination now seen between funding with equity capital or with loan capital.

In support, the 0.5 percent proportional capital duty has been abolished as from *01 January 2006*. The contribution of capital is subject only to a duty of € 25.

### The notional interest deduction is calculated on “adjusted” equity capital

All companies subject to resident or non-resident corporate tax (save exceptions) can deduct an amount based on their “adjusted” equity capital.

The calculation starts with the company’s equity capital<sup>2</sup> at the end of the previous taxable period, which would then be reduced by

- the net fiscal value of own shares, of shares and participations that are part of the financial fixed assets and of shares of investment companies of which the dividends qualify for the dividends received deduction;
- the net worth of foreign permanent establishments and foreign real estate<sup>3</sup>;

<sup>1</sup> See also article 115 of the law of 23 December 2005 implementing the pact for solidarity between the generations (Belgian Official Gazette dd. 30 December 2005).

<sup>2</sup> Based on accounting law “equity capital” includes: capital, share premiums, revaluation gains, reserves (legal reserve, unavailable reserves, tax exempt reserves and available reserves), carry-forward of profits or losses (-) and capital investment subsidies.

- the net book value of tangible fixed assets or parts thereof to the extent that the related costs unreasonably exceed business needs;
- the book value of assets that are held as an investment and that do not generate taxable periodic income;
- the book value of real estate or of other immovable rights of which directors, their spouse or their children have the use;
- tax-free revaluation gains (including revaluation gains incorporated in capital), capital investment subsidies and the tax credit for research & development<sup>4</sup>.

Variations during the accounting year will be taken into account. They are deemed to take place on the first day of the month following the month in which they have occurred.

### **The applicable rate is the average annual rate of the 10-year OLO which is recalculated each year**

The rate of the notional interest deduction for assessment year X (e.g. 2007) is the average of the reference indices J (10-year government bond or "OLO") published on a monthly basis by the *Fonds des rentes/Rentenfonds* for the year X-2 (e.g. 2005). For 2005, the average is 3.442%<sup>5</sup>. As from assessment year 2008, the rate is calculated in the same way *every year* (assessment year 2008 based on the average of the year 2006). For assessment year 2008, the rate is 3,781%. The new rate can deviate maximum 1% from the rate of the year before. Per Royal Decree it can be decided not to apply this limitation, but the rate cannot be higher than the calculated average. The absolute upper limit is in principle 6.5%. The Government can deviate from this by Royal Decree also.

Assessment year	Normal rate	Rate for SMEs
2007	3.442%	3.942%
2008	3.781%	4.281%

### **Deduction is transferable**

If the company's taxable base is not sufficient to completely utilize the notional interest deduction, the difference will be carried over to the next taxable period. In contrast to normal losses that can be transferred without limitation, the unused notional interest deduction can be transferred for only

<sup>3</sup> Net book value of assets minus debt. Applicable to establishments and real estate situated in a country with which Belgium has concluded a tax treaty.

<sup>4</sup> See articles 121 and 132 of the law of 23 December 2005 implementing the pact for solidarity between the generations (*Belgian Official Gazette*, 30 December 2005).

<sup>5</sup> Notice published in the *Belgian Official Gazette*, dd. 16 January 2006.

seven years following the year of the deduction. The notional interest deduction cannot be transferred should there be a change in control of the company that does not meet legitimate financial or economic needs.

## **Entry into force**

This innovative measure entered into force as from assessment year 2007 (this means as from 01 January 2006 for companies that keep their books on a calendar year basis). Each modification to the closing date of the accounting year as from 29 April 2005 will have no effect for the application of the notional interest deduction.

## **Opportunities**

The equity capital at the closing date of the accounting year on 31 December 2005 or later will serve as the basis for the calculation of the deduction for assessment year 2007. The policy for financing new investment (equity versus loan capital) may need to be reevaluated as well as the present and future group structure and especially the location of foreign participations. Repatriations of the equity capital in foreign subsidiaries and the sale of subsidiaries may need to be considered, and the return on each asset may need to be examined and possibly relocated in the “best” possible group company. Simulations have shown that the notional interest deduction may offer a considerable tax benefit, especially for companies with good solvency ratios.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.

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