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Deloitte Legal Newsflash

Declaration of payments to tax havens: Tax audit wave

Since tax year 2011, Belgian companies are required to declare payments of minimum EUR 100,000 made directly or indirectly to recipients established in so called 'tax havens'. The aim is to make those payments more visible for the tax authorities and to facilitate tax audits.

The tax audit wave recently initiated demonstrates that the Belgian tax administration thoroughly investigates the declared payments. This is in line with the government's action plan for combating tax and social fraud of 1 April 2022. In its action plan, the government considers the rules regarding payments to tax havens as an efficient measure against tax fraud.

The first audits show that the tax administration easily considers payments that do not meet the deductibility requirements as non-deductible by applying a stringent administrative position.

Reporting obligation and deductibility requirements for payments to tax havens

Payments made directly or indirectly to tax havens referred to in Article 307, §1/2, ITC must be reported separately.

A State qualifies as a tax haven when it:

a) has been designated by the 'World Forum on Transparency and Exchange of Information in Tax Matters' as a State which does not effectively or substantially apply the standard regarding exchange of information on request (the so-called OECD list);

b) appears on the list of States without or with a low tax rate (this list is included in art. 179 RD/ITC);

c) appears on the EU list of non-cooperative jurisdictions.

Both the qualification of a State as tax haven, and the administrative interpretation of when the conditions are met, are subject to changes.

For example, the tax administration recently changed its position by considering that 'partially compliant' States on the OECD-list also qualify as tax havens (which led to the application of the provisions to payments to Malta and Turkey).

The payments must be declared using a specific form, i.e. Form 275F, which must be attached to the corporate income tax return. Payments that are not declared with the designated form are deemed non-deductible.

Payments correctly included in a Form 275F are, pursuant to article 198, § 1, 10°, ITC, only deductible if: (1) they have been declared, and (2) the taxpayer proves by all legal means that (a) the payments were made within the framework of genuine business transactions and (b) to recipients other than artificial arrangements.

It is this last aspect, in particular, that creates certain difficulties.

Heavy burden of proof for the taxpayer

The tax administration confirmed its interpretation of the scope of the taxpayer's burden of proof regarding the deductibility of payments to tax havens in a recent administrative circular (Circular 2021/C/112 of 20 December 2021).

a) Only payments related to genuine business transactions

The administrative circular clarifies what is to be understood by 'genuine transactions'. According to the tax administration, this concerns: "*professional transactions that genuinely respond to an industrial, commercial or financial need and which normally find, or must find, compensation in the overall business activity.*"

Consequently, according to the tax administration, the taxpayer will have to demonstrate that compensation actually exists. Furthermore, the tax administration requires the payment to be at arm's length in order to meet deductibility requirements.

b) No payments to artificial arrangements

To ensure tax deductibility of the declared payments, it is also required that the payment is made to a recipient that does not qualify as an artificial arrangement.

Again, according to the tax administration, a '(legal) person other than an artificial arrangement' is considered to be "*any (legal) person developing an actual activity in its State of establishment. This implies, inter alia, that the taxpayer can demonstrate, on the basis of objective and verifiable elements, the physical existence of the foreign enterprise in terms of premises, personnel and equipment.*"

The tax administration specifically refers to European Court of Justice case law (Cadbury Schweppes and Eurofood IFSC) to confirm its interpretation regarding wholly artificial arrangements.

In any case, it is necessary for the taxpayer to identify and locate the person benefiting from the transaction. According to the tax administration, the person who (indirectly) receives the payment must be the same as the person who performs the service for which the payment is made.

The tax administration's interpretation of the legal requirements entails a proactive approach from the taxpayer who must collect sufficient evidence in order to be able to deduct payments to tax havens. A prudent taxpayer collects this evidence prior to or upon making the targeted payments. If the taxpayer awaits the tax audit, it might be too late to collect the required documentation regarding the recipient of the payment. This will be the case especially in a context where parties are not related.

New tax audit wave applying a stringent administrative position

This reporting obligation and specific deductibility rules undoubtedly provide an efficient weapon in the tax administration's fight against tax fraud and undesired profit shifting to tax havens. However, the stringent administrative interpretation of the law leads to unjust situations were taxpayers see genuinely deductible costs rejected because they cannot meet the excessive burden of proof the administration requires. It can be expected that the tax authorities will follow the rigid position laid down in the administrative circular. This is confirmed by the (standard) questionnaires used in the new audit wave.

However, on many occasions, taxpayers targeted by the tax administration still have solid arguments based on the law, the intention of the legislator and (EU) case law, to defend the deductibility of payments to tax havens. For example, the tax administration, as an administrative authority, must respect the principle of proportionality when applying the law. Placing an excessive burden of proof on the taxpayer's shoulders can be considered as contrary to this principle. Arguments against preventing the non-deductibility of declared costs must be assessed on case-by-case basis.

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