Belgium

Branch Reporter
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## Summary and conclusions

Under Belgian domestic law, the concept of legal personality serves as the main determinative nexus to classify an entity as a separate taxpayer. The recognition of foreign legal entities for Belgian income tax purposes is governed by the rules of Belgian international private law. The primary conflict of law rule of Belgian international private law determining the legal status and capacity of a legal entity, i.e. the *lex societatis*, is the place of principal establishment of the entity. A company's principal establishment is the place from where the company is effectively managed ("real seat"). The Belgian legal order recognizes *de plano* the legal personality of an entity formed under foreign law provided that it has been validly incorporated under the laws of the state of its principal establishment and that it acquired legal personality under such laws. A legal entity validly incorporated under foreign law is also recognized *de plano* for Belgian income tax purposes and, hence, it is classified as a separate taxable entity for such purposes. If the foreign entity has no legal personality under the laws of the foreign jurisdiction, Belgium will treat the foreign entity as fiscally transparent, regardless of its fiscal treatment in the foreign jurisdiction. If the foreign entity has legal personality under the private (corporate) law rules of the foreign jurisdiction, but is treated as fiscally transparent under the income tax rules of that jurisdiction, Belgium will recognize the separate legal personality of the foreign entity and, hence, treat the entity as a separate taxpayer for Belgian income tax purposes. If the foreign jurisdiction does not recognize the concept of legal personality, the characteristic features of the foreign entity are derived from the *lex societatis* and are subsequently tested against the characteristics that are attributed under Belgian law to legal entities (*lex fori*). In cases where Belgium is the state of source, a comparability test is applied: the foreign entity will be treated as a separate taxable entity for Belgian income tax purposes if it is an association, institution or body without legal personality that is established in a legal form that is comparable with the legal form of a corporation under Belgian law.

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The tax treaties concluded by Belgium generally follow the OECD model tax convention. While formally having the status of soft law, the OECD model tax convention and the commentary thereon appear to be accepted – and used – by Belgium as means of interpretation in a tax treaty context. There are strong indications that the same holds true, *mutatis mutandis*, in respect of the 1999 OECD Partnership Report, most of which became part of the OECD commentary. First, Belgium did not formulate any reservations on the OECD Partnership Report. Second, in a 2004 circular letter, the Belgian tax administration confirmed the approach suggested in the OECD Partnership Report regarding income qualification issues arising as a result of asymmetrical entity classification (the position was reconfirmed in later circular letters). Third, the case law of the Supreme Court suggests, at least implicitly, that it adheres to the solutions offered by the OECD Partnership Report. Fourth, the Ruling Commission also seems to apply the findings of the OECD Partnership Report. Finally, the OECD principles are reflected in Belgium's (more recent) treaty policy. Against this backdrop, it is reasonable to conclude that Belgium is likely to adhere to (and to apply in a tax treaty context) the principles of the OECD Partnership Report, as reflected in the OECD commentary. This has implications, in a tax treaty context, in terms of both entity classification and income qualification. As regards entity classification (and, hence, treaty entitlement), Belgium as state S will take account of the subjective qualification of the entity by the state where the entity is organized. If the entity is a resident of state P and is liable to tax there (and thus is a resident of state P), Belgium will follow state P's subjective qualification of the entity and, hence, the entity will be entitled to directly invoke the tax benefits under the P–Belgium tax treaty. It follows that Belgium's domestic entity classification rules become irrelevant and moot, at least in a tax treaty context where Belgium is the state of source. If the entity is a resident of state P but not liable to tax there (and thus is not a resident in state P), Belgium will authorize the partners "behind" the entity to invoke the tax treaty concluded by Belgium with their state of residence inasmuch as the income of the entity is allocated to the partners for tax purposes in state R. In such a case, Belgium remains free (for Belgian domestic tax purposes) to classify the entity according to its own domestic law criteria. As regards income qualification issues arising as a result of asymmetrical entity classification, Belgium is likely to apply the article 23 approach suggested in the OECD Partnership Report. In other words, where state S considers a given treaty provision to be applicable to the income at issue, as the case may be taking into account the qualification of that income under its domestic law, and that treaty provision attributes the taxing power to state S, then Belgium as state R will be bound by the interpretation of state S and, hence, will have to grant relief in conformity with the relevant provision of the tax treaty that is analogous to article 23 of the OECD model tax convention. However, in order to avoid cases of double non-taxation, Belgium will in principle be entitled not to grant relief if state S has applied the provisions of the relevant tax treaty to exempt the underlying income or applied the treaty provisions mirroring the provisions of paragraph 2 of article 10 or 11 of the OECD model tax convention to such income.

# 1. Entity qualification in domestic tax law

## 1.1. Domestic entities

### *1.1.1. Entities as taxpayers of income taxes*

Throughout the (overall system underlying the) Belgian Income Tax Code (ITC), the concept of legal personality serves as the main determinative nexus to classify an entity as a separate taxpayer. Thus, articles 179 *juncto* 2, §1, 5(a) of the ITC, defining the concept of "corporation", require an entity to have legal personality in order to come within the scope of application of the corporate income tax.[1] In the same vein, article 18 of the ITC qualifies the income derived by partners from the entity in which they participate as dividends, but only provided that the distributing entity is a "corporation", thus again (indirectly) referencing the prerequisite of legal personality. Conversely, article 29, §2 of the ITC classifies a number of specific Belgian corporate forms as fiscally transparent simply by stating that these corporate forms are deemed to be associations without legal personality (for income tax purposes). Articles 29, §1 *juncto* 364 of the ITC directly attribute (and tax) the income (whether with or without income conversion) derived via a fiscally transparent entity to its partners or members, regardless of whether or not such income is actually distributed by the relevant entity.

### *1.1.2. "Domestic" nature of an entity*

An entity is a "domestic" entity in Belgium if it has its fiscal domicile in Belgium. Article 2, §1, 5(b) of the ITC specifies that the fiscal domicile of a company is its statutory seat, its principal establishment or its seat of management or administration. It is generally accepted in legal doctrine that all these concepts fuse together into the criterion of "effective seat of management or direction", i.e. the emanation *in fiscalibus* of the "real seat" doctrine to which Belgium adheres. A company that is effectively managed from Belgium is, therefore, a "domestic" corporation subject to the Belgian corporate income tax.

### *1.1.3. Key factors for classifying an entity as a taxable one*

As indicated above, the concept of legal personality serves as the main determinative nexus for classifying an entity as a separate taxpayer. For corporate income tax purposes, a "taxable entity" is an entity that (a) has separate legal personality; (b) is engaged in business or profit-making activities; and (c) has its fiscal domicile (see above) in Belgium.

1 See also art. 220 of the ITC subjecting all legal entities that are not engaged in a business or a profit-making activity to the legal entities tax.

### 1.1.4. Relevance of corporate law status

Only entities with separate legal personality can be subject to Belgian corporate income tax. Belgian tax law does not define the concept of "legal personality" and, thus, reference should be made to the meaning of that concept under (corporate) private law. Unless the tax statute expressly provides so, it is not possible in a domestic context that a corporate vehicle is de-classified for tax purposes to become a non-taxable entity or vice versa.

The Companies Code enumerates the corporate legal forms that are "eligible" for legal personality. For these legal forms to be accredited legal personality, it is required that an extract of the incorporation deed be filed with the clerk's office of the competent Commercial Court.

### 1.1.5. General reference to corporate law or list/catalogue approach

By construing legal personality as an essential condition for becoming subject to income tax, it can be said that Belgian income tax law contains a general reference to corporate law in this regard.

### 1.1.6. Typical taxable entities

The most common legal forms for corporations in Belgium are the public limited liability company (*société anonyme/naamloze vennootschap*) and the private limited liability company (*société privée à responsabilité limitée/besloten personenvennootschap met beperkte aansprakelijkheid*) and, provided they have acquired legal personality, they are the typical separate taxable entities that are used in a business context in Belgium.

### 1.1.7. Mandatory or optional classification

The only remaining option is the one available to agricultural companies (article 29, §2, 2 of the ITC).

### 1.1.8. Varying tax status of an entity

This is not applicable.

### 1.1.9. Fictional taxable entities

This is not applicable.

### 1.1.10. Registration with tax administration or other approvals

Status as a taxable entity does not require registration with the tax administration in Belgium. Rather, as indicated, the obtaining of legal personality is conclusive for status as a taxable entity.

#### 1.1.11. Timing dimension

Obtaining legal personality is the starting point for taxable entity status. Liquidation is the ending point (a company that is dissolved remains subject to corporate income tax until the closing of its liquidation).

#### 1.1.12. All or nothing vs. partial

This is not applicable.

#### 1.1.13. Effect of tax exemptions

The guiding principle in Belgium is that taxable entities that benefit from a preferential tax treatment remain subject, in principle, to corporate income tax. Rather, the specific (preferential) tax treatment derives from the way the tax base is determined. For example, qualifying investment companies are subject to corporate income tax, but on an "alternative" tax base that is composed of (a) abnormal or gratuitous advantages received; (b) disallowed expenses (*dépenses non-admises/verworpen uitgaven*); and (c) secret commission paid.[2]

#### 1.1.14. Group taxation

Belgian tax law does not recognize the concepts of group (relief) taxation or fiscal consolidation for income tax purposes.

### 1.2. Foreign entities

#### 1.2.1. "Foreign" nature of an entity

Belgium adheres to the "real seat" doctrine in order to assess whether a company is Belgian or foreign (see above at section 1.1.2).

#### 1.2.2. Key criteria for classifying foreign entities as taxable

The key criterion for classifying foreign entities as taxable entities is legal personality. The recognition of foreign legal entities for Belgian income tax purposes is governed by the rules of Belgian international private law. The primary conflict of law rule of Belgian international private law determining the legal status and capacity of a legal entity, i.e. the *lex societatis*, is the place of principal establishment of the entity.[3] A company's principal establishment is the place from where the company is effectively managed ("real seat" doctrine). Based upon these criteria, the following typology can be drawn up.

2 ITC, art. 185*bis*.

3 Arts. 111, §1, 1 and 110 of the International Private Law Code (unless *renvoi* to the laws of the state of incorporation).

#### 1.2.2.1. The foreign jurisdiction recognizes the concept of legal personality

(a) The foreign entity has legal personality under the private (corporate) law rules of the foreign jurisdiction and is treated as a taxable entity under the laws of the foreign jurisdiction. Under Belgian international private law, the Belgian legal order recognizes *de plano* the legal personality of an entity formed under foreign law provided that it has been validly incorporated under the laws of the state of its principal establishment and that it acquired legal personality under such laws. A legal entity validly incorporated under foreign law is also recognized *de plano* for Belgian income tax purposes and, hence, it is classified as a separate taxable entity for such purposes.

(b) The foreign entity has no legal personality under the laws of the foreign jurisdiction. Belgium accepts the lack of legal personality and will treat the foreign entity as fiscally transparent, regardless of its fiscal treatment in the foreign jurisdiction.[4] This may result in double taxation.

Double taxation arises if Belgium treats the foreign partnership or entity as fiscally transparent as it lacks legal personality under the private (corporate) law rules of the foreign jurisdiction and, hence, imposes tax on the Belgian partners on their proportionate share of the partnership income, while at the same time the foreign jurisdiction (in the likely event that it also treats the partnership or entity as fiscally transparent as it lacks legal personality) considers that the non-resident partners have a permanent establishment in its jurisdiction and taxes them on their proportionate share of income on that basis. Double taxation may also arise in the – admittedly – more unlikely scenario that the foreign jurisdiction treats the entity as a separate taxpayer despite its lack of legal personality.

(c) The foreign entity has legal personality under the private (corporate) law rules of the foreign jurisdiction, but is treated as fiscally transparent under the income tax rules of that jurisdiction. Belgium will recognize the separate legal personality of the foreign entity and, hence, treat the entity as a separate taxpayer for Belgian income tax purposes. This may result in double taxation.

Double taxation stems from the fact that the non-resident partners of such an entity are taxed in the state of source if the entity derives income sourced there (e.g. income from real property), while the Belgian tax authorities, because they recognize the legal personality of the entity (without having regard to its fiscally transparent status in the state of source), will tax the Belgian resident partners on foreign-source dividends at the time the entity distributes its profits for which no relief from double taxation is provided: for corporate partners, the dividends received deduction is denied because the taxation condition is not satisfied; for individual partners, double taxation results from the fact that the tax credit in respect of foreign-source dividends has been abolished. An illustration of this line of reasoning is the *Prince de Ligne* case, concerning a French *société civile immobilière* (SCI).[5]

4 See e.g. Court of Appeals of Ghent, 18 September 2007, *TFR*, 2008, 542.

5 Court of Appeals of Brussels, 4 June 1974, *JDF*, 1975, 82; see also, Court of Appeals of Brussels, 7 November 2002, *TFR*, 2003, 242 with a critical annotation by P. Faes.

### 1.2.2.2. The foreign jurisdiction does not recognize the concept of legal personality

Belgium will apply the *lex societatis* conflict of law rule, i.e. the characteristic features of the foreign entity are derived from the *lex societatis* and are subsequently tested against the characteristics that are attributed under Belgian law to legal entities (*lex fori*) (hereinafter referred to as the "combined *lex societatis/lex fori* analysis"). Double taxation may result.

See e.g. the classification of a US general partnership by the Brussels Court of Appeals in 1998.[6] The case concerned a Belgian company that owned shares in a US general partnership, which in turn owned shares in a US limited partnership active in the US real estate sector. The Court assessed whether on the basis of the *lex societatis* the general partnership classified as a legal person. However, as applicable US law does not as such apply the concept of legal personality but rather applies features of both an "entity approach" (emphasizing for certain aspects the proper nature of the partnership) and an "aggregate approach" (whereby the rights and obligations of the partnership are imputed to the partners), the Court therefore took account of the characteristic features of the general partnership and subsequently tested such features against those that would be attributed to Belgian legal persons. *In casu*, the Court concluded that the general partnership had no separate legal personality as there were separate capital accounts for the partners, all profits and losses were directly allocated to the partners, the partners were personally liable for the debts of the partnership, the partnership entered into dissolution in case of death, serious illness, bankruptcy or incapacity of one of the partners or in case of alienation of a substantial part of the assets, and an individual partner could not unilaterally withdraw from the partnership prior to its dissolution. On this basis, the general partnership was classified as fiscally transparent and, hence, the income earned by the partnership was directly attributed to the Belgian partner in proportion to the latter's holding in the partnership.

### 1.2.2.3. Comparability test

In cases where Belgium is the state of source, article 227, 2 of the ITC provides for a comparability test: the foreign entity will be treated as a separate taxable entity for Belgian income tax purposes if it is an association, institution or body without legal personality that is established in a legal form that is comparable with the legal form of a corporation under Belgian law.

It is unclear what "a legal form that is comparable with the legal form of a corporation under Belgian law" actually means as the legislature has omitted to define the criteria on the basis of which the assessment is to be made. Legal doctrine is unanimous that the criteria must be derived from corporate law (as opposed to tax law) and that relevant criteria include factors such as centralization of management, limited liability of the partners, transferability of shares/parts, and continuity of the entity.[7]

[6] Court of Appeals of Brussels, 30 April 1998, *AFT*, 1999, 119.
[7] B. Peeters, *Fiscale transparantie: Toerekening van inkomsten. Een onderzoek naar de classificatie van grensoverschrijdende samenwerkingsverbanden*, Ghent, Larcier, 2011, p. 31 *et seq.*

### 1.2.3. List of foreign legal forms

This is not applicable.

### 1.2.4. Comparability test

See section 1.2.2.3.

### 1.2.5. Relevance of foreign tax treatment

The fiscal treatment of the entity in the foreign jurisdiction is irrelevant for entity classification for Belgian income tax law purposes.

### 1.2.6. Optionality

This is not applicable.

### 1.2.7. Advance clarification

See section 2 of this report.

# 2. Case studies on tax treaty entity qualification issues

## 2.1. Introduction

The tax treaties concluded by Belgium generally follow the OECD model tax convention. While formally having the status of soft law, the OECD model tax convention and the commentary thereon appear to be accepted – and used – by Belgium as a means of interpretation in a tax treaty context. There are strong indications that the same holds true, *mutatis mutandis*, in respect of the report adopted by the OECD Committee on Fiscal Affairs on 20 January 1999 *The Application of the OECD Model Tax Convention to Partnerships* (OECD Partnership Report), most of which became part of the OECD commentary. We base this statement on the following considerations.[8] First, Belgium did not formulate any reservations on the OECD Partnership Report. Second, in a 2004 circular letter, the Belgian tax administration confirmed the approach suggested in the OECD Partnership Report regarding income qualification issues arising as a result of asymmetrical entity classification (the position was reconfirmed in later circular letters). Third, the case law of the Supreme Court suggests, at least implicitly, that it adheres to the solutions offered by the OECD Partnership Report. Fourth, the Ruling Commission also seems to apply the findings of the OECD Partnership Report. Finally, the OECD principles are reflected in Belgium's (more recent) treaty policy.

8 See also D. Van Bortel, "Het classificatievraagstuk. Buitenlandse transparante entiteiten in het Belgische belastingrecht", *AFT*, 2009, 62 *et seq.*

Thus, it is reasonable to conclude that Belgium is likely to adhere to (and to apply in a tax treaty context) the principles of the OECD Partnership Report, as reflected in the OECD commentary. Logically, this conclusion – which will be the working assumption throughout the remainder of this report – has implications, in a tax treaty context, for Belgium's approach both in terms of entity classification and income qualification.

As regards entity classification (and, hence, treaty entitlement), Belgium as state of source (state S) will take account of the subjective qualification of the entity by the state where the entity is organized. If the entity is a resident of state P and is liable to tax there (and thus is a resident of state P), Belgium will follow state P's subjective qualification of the entity and, hence, the entity will be entitled to directly invoke the tax benefits under the P–Belgium tax treaty. It follows that Belgium's domestic entity classification rules become irrelevant and moot, at least in a tax treaty context where Belgium is the state of source.[9] If the entity is a resident of state P but not liable to tax there (and thus is not a resident in state P), Belgium will authorize the partners "behind" the entity to invoke the tax treaty concluded by Belgium with their state of residence inasmuch as the income of the entity is allocated to the said partners for tax purposes in state R. In such a case, Belgium remains free (for Belgian domestic tax purposes) to classify the entity according to its own domestic law criteria.

As regards income qualification issues arising as a result of asymmetrical entity classification, Belgium is likely to apply the article 23 approach suggested in the OECD Partnership Report. In other words, where state S considers a given treaty provision to be applicable to the income at issue, as the case may be taking into account the qualification of that income under its domestic law, and that treaty provision attributes the taxing power to state S, then Belgium as state R will be bound by the interpretation of state S and, hence, will have to grant relief in conformity with the relevant provision of the tax treaty that is analogous to article 23 of the OECD model tax convention. However, in order to avoid cases of double non-taxation, Belgium will in principle[10] be entitled not to grant relief if state S has applied the provisions of the relevant tax treaty (as opposed to provisions under the domestic laws of state S) to exempt the underlying income or applied the treaty provisions mirroring the provisions of paragraph 2 of article 10 or 11 of the OECD model tax convention to such income.

Illustrative of these principles is the decision of the Supreme Court of 2 December 2004 rendered in respect of French-source real property income received by a Belgian resident who was a shareholder of a French SCI, a legal person under French law but treated as fiscally transparent (*translucide*) for French domestic tax law purposes. The Supreme Court accepted that the income of the SCI was taxable in France as income from "real property", that the income qualification in the state of source (France) was binding upon Belgium, and that as a result Belgium had to exempt the income.[11] Although the Supreme Court did not explicitly

9 P. Faes, "Partnerships: commentaargebonden kwalificaties", *TFR*, 2000, 956, no. 9.

10 See, however, the Belgian tax authorities' extensive interpretation of the *exemption vaut impôt* doctrine discussed below.

11 Cass., 2 December 2004, which reversed Court of Appeals of Brussels, 7 November 2002 (note 7); certain lower courts continue to dissent from the Supreme Court's case law: see e.g. Court of First

refer to the OECD Commentary or OECD Partnership Report, it is beyond doubt that the conclusion that it reached is fully consistent with the principles laid down therein.[12]

The OECD Partnership Report approach is also reflected in a 2004 circular letter issued by the Belgian tax administration.[13] This circular letter refers to examples that are directly derived from the OECD Partnership Report and OECD commentary and accepts the principle that relief from double taxation must be granted by Belgium (as state R) if state S has taxed the income in accordance with the provisions of the applicable tax treaty based on its domestic law classification rules. As regards the *method* to avoid double taxation, however, the circular letter seems to suggest that Belgium is not bound by the entity classification under the laws of the other contracting state.[14] The applicability of the OECD Partnership Report approach in Belgium has been reconfirmed by the Belgian tax administration in its circular letter dated 6 April 2010 in which, surprisingly, the reservation made in the 2004 circular letter on the method to grant tax relief was omitted.[15]

There is also a clear tendency in the decisions of the Belgian Ruling Commission to follow an approach that is overall consistent with the OECD Partnership Report. This can be best illustrated with a series of rulings rendered by the Ruling Commission with respect to UK limited liability partnerships (LLPs). In these rulings, the Ruling Commission accepts that foreign-source income earned via a UK LLP, despite the fact that this entity has legal personality under UK law (and therefore should be deemed a separate taxpayer under Belgian domestic entity classification rules), is to be attributed to the Belgian partners and is to be exempt in Belgium (and thus not to be treated as taxable dividend income in their hands).[16] In a ruling in respect of US real property held by a Belgian resident through a US limited liability company (LLC) (not treated as a corporation and thus not resident for US tax purposes), the Ruling Commission held that the Belgian resident

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Instance of Brussels, 11 February 2010, treating the income under the "other income" article of the Belgium–France tax treaty.

12 L. De Broe and M. De La Serna, "Het toepassingsgebied van het territorialiteitsbeginsel in het Belgisch fiscaal recht: het voorbeeld van inkomsten die worden uitgekeerd door Franse burgerlijke vastgoedvennootschappen", *AFT* 2005, p. 18; K. De Haen, *Fiscale transparantie – een rechtsvergelijkende analyse*, Wolters Kluwer, Mechelen, 2007, p. 70.

13 Circular letter no. AFZ 5/2004 (AFZ/2004/0053) of 16 January 2004.

14 This "bipolar" approach is criticized by legal scholars: see e.g. W. Huygen, "General Scope", in *The New USA–Belgium Double Tax Treaty: A Belgian and EU Perspective*, Ghent, Larcier, 2009, p. 26, no. 1.28.

15 Circular letter AFZ no. 4/2010 of 6 April 2010 (Addendum to Circular letter no. Ci.R9.Div/577.956 of 11 May 2006).

16 See e.g. Rulings nos. 300.230, 400.373, 500.03, 500.04, 500.76 of 26 May 2005; nos. 400.233 of 23 June 2005; no. 500.210 of 22 September 2005; no. 500.199 of 20 October 2005; no. 500.252 of 24 November 2005; no. 600.059 of 23 March 2006; no. 700.484 of 17 June 2008; no. 800.249 of 28 April 2009; no. 800.347 of 16 June 2009; no. 900.260 of 17 November 2009; no. 900.421 of 9 March 2010; no. 2010.221 of 13 July 2010; no. 2010.229 of 24 August 2010; no. 2011.239 of 12 July 2011; no. 2011.276 of 18 October 2011; no. 2011.301 of 13 September 2011. There is criticism on the decisions *inter alia* as far as the tax treatment of the Belgian-source income of the Belgian partners is concerned: despite (the recognition of) the legal personality of the LLP, the Ruling Commission applies a sort of "semi-fiscal transparency" to such income (taxation in the hands of the partners rather than at the level of the partnership); a possible explanation is that the Ruling Commission considers this aspect to be a purely domestic matter.

was directly entitled to the benefits of the (old) USA–Belgium tax treaty as he was to be considered as having directly obtained the income derived through the LLC; as regards the income qualification conflict, i.e. real property income for US domestic tax law purposes *vs.* dividend (at the time of attribution or payment of the LLC income to the Belgian resident) for Belgian domestic tax purposes (as the LLC had legal personality), the Ruling Commission decided that Belgium was bound by the qualification given to the income by the state of source (the USA) and, hence, had to exempt the income (under the exemption with progression method).[17] For both branches of its ruling, the Ruling Commission explicitly referred to the OECD commentary (as amended in furtherance of the OECD Partnership Report). A similar approach has been followed in other rulings, for example regarding the tax treatment of investments via a French general partnership (*société en nom collectif*).[18]

Lastly, the OECD Partnership Report approach is embedded in Belgium's recent treaty policy. Specific treaty provisions on transparency have been included in the 2007 Belgian (draft) model convention and the subsequent 2010 Belgian (draft) model convention. For example, in the method article (article 22 of the 2010 Belgian (draft) model convention) it is explicitly stated that the income that is qualified as a "dividend" under Belgian domestic law will be tax exempt in Belgium if it is distributed by an entity that is fiscally transparent under the laws of the state of source. A similar provision has been included in some of the more recent double tax treaties concluded by Belgium (e.g. the treaties with the USA and the Netherlands).

While these examples thus seem to confirm that the solutions advanced by the OECD Partnership Report become increasingly established in Belgium, there remain, however, two complications. The first complication concerns the question of whether these solutions can be applied in the context of tax treaties concluded by Belgium prior to the publication of the OECD Partnership Report and the insertion of its principles in the OECD commentary (and the Belgian model convention). It is no secret that the OECD is a strong advocate of dynamic interpretation of the commentary and thus considers that amendments and additions to the commentary are applicable to tax treaties concluded before the implementation of such amendments and additions.[19] However, this is a matter of controversy in Belgium. Specifically in respect of the OECD Partnership Report, certain legal authors are of the opinion that the solutions proposed therein are so radical that they cannot be applied unless they are explicitly stated in the text of a specific tax treaty.[20] Notwithstanding this, there are indications that the Ruling Commission[21] and recent case law[22] adhere to dynamic interpretation in this area. A second complication,

17 Ruling no. 600.252 of 24 October 2006; see also Ruling no. 600.220 of 12 December 2006; no. 800.197 of 12 August 2008; no. 2011.523 of 20 December 2011; no. 2012.096 of 24 April 2012.

18 Ruling no. 700.526 of 12 February 2008.

19 OECD commentary, introduction, para. 33 *et seq.*

20 W. Huygen, "Het OESO rapport inzake partnerships: een kritische analyse", *AFT*, 2002, 389; cf. the reservation made by the Netherlands on the OECD Partnership Report.

21 See Ruling no. 600.252 of 24 October 2006; Ruling no. 800.347 of 16 June 2009; Ruling no. 900.421 of 9 March 2010.

22 Court of Appeals of Ghent, 3 January 2012 (discussed by R. Van Den Eeckhaut, "Beroepsinkomsten uit meerdere landen: kosten omdelen?", *Fiscoloog (I.)* 2012, no. 340, p. 1); Court of First Instance

while general in nature and therefore technically not specific to partnerships, relates to the fact that certain tax treaties concluded by Belgium do not mirror exactly the expression "may be taxed in the [State of source]" of article 23 of the OECD model tax convention, but rather use the expressions "is taxed in the [State of source]"[23] or "is subject to tax in the [State of source]". The Belgian tax authorities interpret this "subject to tax" requirement (in application of article 3(2) of the OECD model tax convention) on the basis of (a rather extensive application of) the so-called *exemption vaut impôt* doctrine,[24] whereby (unless the contracting states have agreed upon a specific meaning of the term "taxed") income is treated as "taxed" abroad if it has been subject to the normal tax regime applicable in the state of source, even if that tax regime consists of an (explicit) exemption; in other words, income may be treated as "taxed" if the state of source's tax legislation explicitly exempts that income or explicitly treats that income as non-taxable, i.e. if the absence of taxation is based on a specific provision of the state of source's tax legislation.[25] Nonetheless, (recent) case law[26] and authoritative doctrine[27] appear to be putting (mounting) pressure on the tax authorities' liberal interpretation of the "subject to tax" requirement by considering that the term "taxed" necessarily implies effective taxation (whereas the term "subject to tax" must be interpreted as "in principle subject to tax").

## 2.2. Case studies[28] – analysis and discussion[29]

### *2.2.1. Treaty entitlement*

#### 2.2.1.1. Case A

(a) There will be a double entitlement to treaty benefits with respect to the same income. P should be considered by Belgium (as state S) to be entitled to the benefits of the S–P tax treaty in respect with the interest/royalties it derives

*cont.*

Brussels, 20 November 2009 (cited by L. De Broe and D. Van Bortel, "Internationaal belastingrecht 2010", *TRV*, p. 101, no. 24).

23 See e.g. art. 22 (1)(a) of the 2006 US–Belgium tax treaty.

24 The *exemption vaut impôt* doctrine is based on the decision rendered by the Supreme Court in the *Sidro* case: Cass., 12 September 1970, Pas., 1970, I, 37 and is shared by the majority of legal doctrine.

25 Circular AOIF 21/2006 of 11 May 2006; see also, Com. ITC 92, para. 155/20 and Com. DTT, para. 23/112.

26 Court of Appeals of Brussels, 17 January 2008, discussed by M. Van keirsbilck, "Komt 'exemption vaut impôt' op de helling te staan?", *Fiscoloog (I.)* 2008, no. 294, p. 1; Court of Appeals of Brussels, 8 March 1988, *FJF*, no. 88/113, discussed by L. De Broe, "Buitenlandse belastingheffing als voorwaarde van vrijstelling", *Fiscoloog (I.)* 1988, no. 56, p. 5.

27 M. Van keirsbilck, "Relief from Double Taxation", in *The New USA–Belgium Double Tax Treaty: A Belgian and EU Perspective*, Ghent, Larcier, 2009, p. 468, no. 22.22; L. De Broe and N. Bammens, "The interpretation of 'subject to tax' clauses in Belgian tax treaties: A critical analysis of the 'exemption vaut impôt' doctrine", *BIT*, 2009, pp. 68–73.

28 For further details on all case studies, please refer to the General Report.

29 Unless stated otherwise, the discussion focuses on tax treaties that follow the OECD model tax convention (which is the case for most tax treaties concluded by Belgium). Throughout the discussion, P is the entity, state P is the state of organization of the entity, state S is the state where the income is sourced and state R is the state of residence of the partners/members/shareholders.

from Belgium, as P is liable to tax in state P. On the other hand, the partners, residents of state R, will be considered to be entitled to the benefits of the S–R tax treaty as state R treats P as fiscally transparent and, hence, treats the partnership income as being taxable in the hands of the partners. The tax treatment of P in Belgium (whether as transparent or taxable entity) has no impact on this result. This double entitlement to treaty benefits will be satisfied by Belgium imposing the lowest amount of tax allowed under the two treaties.[30]

(b) Belgium as state R, treating the entity as fiscally transparent, should grant a credit for the (reduced) withholding tax levied in state S under the S–Belgium treaty. A complication is, however, that Belgium abolished (in 1984 and 1988) the foreign tax credit for dividends, interest and royalties for Belgian resident individuals not acting in a professional capacity. For tax treaties that were in force at the time of the abolition, the question arises whether such abolition is treaty compliant, which is dependent on the way the foreign tax credit clause in the relevant tax treaty is worded.[31] Because of the principle of the relative effect of treaties and capital export neutrality, Belgium cannot refuse the foreign tax credit (if any, see the previous sentence) on the basis that the withholding tax in state S was levied on behalf of P and will already be credited in state P at the level of P.

### 2.2.1.2. Case B

(a) In this situation, Belgium as state S will be entitled to tax the income without restriction. The reason is that P is not liable to tax in state P and is therefore not a resident of state P for purposes of the P–Belgium tax treaty. Similarly, though P is treated as the taxpayer for purposes of the domestic laws of Belgium and the income is allocated to P under the domestic laws of state R, P is not liable to tax in state R because it is not treated as a resident. Finally, though the partners are potentially liable to tax as residents in state R, under state R's allocation rules the income is not allocated to them but to P. Thus, P is not a resident of state R and the partners "behind" P are not entitled to benefit from the R–Belgium tax treaty with respect to the partnership's income. The position may be different if the Belgium–P tax treaty extends treaty benefits to fiscally transparent entities. Under Belgium's tax treaties, such extended treaty entitlement only applies to certain types of entities considered fiscally transparent by state P and established according to the laws of a contracting state,[32] but sometimes the relevant treaty provision uses a more general and explicit wording allowing treaty benefits to all entities classified as fiscally transparent under the laws of state P.[33] An in-depth analysis of the particular treaty provision would therefore be required.[34]

30 OECD Partnership Report, (15)-32, para. 74.

31 See for a typology of tax treaties in this respect: D. Wyntin, "Grensoverschrijdende inkomsten uit roerend vermogen, inzonderheid uit interesten, dividenden en royalty's", in *Fiscaal Praktijkboek 1993–1994 Internationaal*, Deurne, Kluwer, 1994, pp. 28–34.

32 See e.g. art. 4(1) of the treaty concluded between Belgium and Germany.

33 See e.g. art. 4 of the Belgium–Tunisia tax treaty.

34 See e.g. art. 25, §1, subs. 1 of the Belgium–Netherlands treaty in respect of (fiscally transparent) collective securities investment enterprises.

(b) Belgium as state P treats the entity as fiscally transparent for Belgian tax purposes, and will therefore tax the underlying partners. The applicable taxation rules will be those applying to non-resident taxpayers (having a permanent establishment in Belgium). Belgium is unlikely to allow a credit for the (reduced) withholding tax levied in state S under the non-discrimination clause of the Belgium–R tax treaty. The reason is that the Belgium–R treaty will be deemed non-applicable because state R does not follow the look-through approach. As a result, the partners should be unable to claim the application of the (non-discrimination clause of the) Belgium–R treaty to indirectly apply the S–Belgium treaty.[35]

### 2.2.1.3. Case C

(a) The Belgium–R tax treaty will be applicable in order to reduce withholding taxes on interest and royalties. The reason is that P may not claim benefits under the Belgium–state P tax treaty since it is not a resident of state P (it is not liable to tax in state P). On the other hand, as state R allocates the income to the partners "behind" P, the partners are liable to tax on that income and are entitled to benefits under the Belgium–R tax treaty. The position may be different if the Belgium–P treaty extends treaty benefits to fiscally transparent entities.
(b) If Belgium is state P and the interest and the royalties are attributed to a permanent establishment in Belgium, it might be argued that Belgium should grant a credit for the (reduced) withholding tax levied in state S. This would imply an "indirect" access of the partners "behind" P to the Belgium–S tax treaty on the basis of the non-discrimination clause contained in the Belgium–R tax treaty. Such "indirect" access has been applied (albeit in a different context) in case law where it was held that a Belgian permanent establishment of an Indian company could claim the tax sparing credit under the tax treaty concluded between Belgium and India on the basis of the non-discrimination clause.[36]
(c) See case A(b) in section 2.2.1.1 above. In addition, however, Belgium will need to examine whether the income derived from state S is attributable to a permanent establishment in state P, in which case Belgium would also need to respect the P–R tax treaty and provide treaty relief for the tax paid in state P. A combined application of both treaties might therefore be required.

### 2.2.1.4. Case D

(a) See case A(a) in section 2.2.1.1 above.
(b) Belgium as state P treats the Belgian entity as a taxable entity for Belgian tax purposes, and will therefore tax P. Thus, the Belgium–S tax treaty should be applicable. As a result, if state S levied a reduced withholding tax, Belgium will be obliged to credit that tax, even if state S levied that withholding tax on

[35] B. Peeters, *op. cit.*, p. 742, with references to dissenting scholars.
[36] Court of First Instance of Brussels, 9 November 2006; see L. De Broe and N. Bammens, "Ook tax sparing-credit voor Belgische VI van Indiase vennootschap", *Fiscoloog (I)*, 2007, 4.

behalf of the partners in state R. The credited amount, however, will be limited to the tax effectively withheld in state S (unless the tax treaty provides for a tax sparing credit).

### 2.2.1.5. Case E

(a) See case B(a) in section 2.2.1.2 above.
(b) Belgium as state R treats the entity as a separate taxpayer. As a result, it will only consider the income distribution by P to the Belgian partners as a taxable event. In that event, Belgium is likely to grant tax relief pursuant to the provision of the Belgium–P tax treaty mirroring article 23 of the OECD model tax convention (see below case G(b) in section 2.2.1.7). For the same reasons, no credit should be available under the S–Belgium treaty.

### 2.2.1.6. Case F

(a) Belgium as state S is bound by state P's subjective qualification. As P is a resident of state P and is liable to tax therein and should therefore be considered to be the recipient and beneficial owner of the interest/royalties income derived from Belgium, only the Belgium–P tax treaty should be applicable.
(b) Belgium as state P treats the entity as non-transparent. The initial payment of the interest or royalty income and the subsequent distribution to its shareholders are to be seen as two separate taxable events. As far as the first taxable event is concerned (attribution of interest or royalties), the applicable tax treaty will be the state S–Belgium treaty as the recipient of the income, P, is a resident of state P. As a result, if state S levied a reduced withholding tax, Belgium would be obliged to credit that tax, even if state S levied the withholding tax on behalf of the partners in state R. The requirement for Belgium to grant such credit, despite the fact that the (reduced) withholding has been levied on behalf of the individual shareholders, which are not residents of state P, derives from the obligation of state S to apply the S–Belgium treaty. Moreover, article 23B of the OECD model tax convention does not require that both states (state S and state P) levy the tax for which a credit is provided in the hands of the same beneficiary.[37]

### 2.2.1.7. Case G

(a) Belgium as state P is likely to view this fact pattern as a purely domestic matter because, from its perspective, P is a resident taxpayer and as such liable to tax on its income arising in state P, i.e. Belgium is simply taxing the domestic source income of a resident taxpayer and nothing in the (interest/royalty articles of the) Belgium–R tax treaty can limit that right.[38]

[37] R.L. Doernberg and K. Van Raad, "Hybrid entities and the US model income tax treaty", *Tax Notes International* 1999, 47.

[38] This analysis coincides with the majority view of the OECD Committee on Fiscal Affairs in the OECD Partnership Report, R(15)-51/52, para. 131.

(b) Belgium as state R treats the entity as fiscally transparent. Belgium is likely to accept that it is bound – for tax treaty purposes – by the income qualification of state S (which coincides with state P in the given fact pattern) and, in that case, Belgium will have to grant tax relief if state S levies tax in accordance with the tax treaty at hand.[39] However, Belgium, as state R, would not have to grant a credit on the tax levied in state P at the level of the entity. The reason is that only state P will (possibly) recognize the subsequent income distribution by the entity to the partners (second income stream); given the transparency of the entity under the laws of Belgium, Belgium will not recognize this second income stream and, hence, should not be obliged to grant a tax credit in respect thereof.[40]

#### 2.2.1.8. Case H

(a) Two approaches appear to be theoretically possible. Under the first approach, the royalties may only be taxed in state P because P qualifies as a resident of state P and is the beneficial owner of the royalties arising in state R, thus satisfying the conditions of article 12.1 of the OECD model tax convention (assumed to be reflected in the R–P tax treaty). Under the second approach, because article 12 of the OECD model tax convention does not affect taxation that is based on residence but only taxation that is based on source, state P should allow state R to consider that the partners, resident in state R, may be deemed to have received their share of the royalties for the purposes of taxation in that state so that the limitation of article 12 does not apply since that article is only applicable where royalties arising in state R have been paid to a resident of the other State (whereas, in the case at hand, the royalties have been paid to a resident of state R). The latter approach, supported by a majority of the OECD Committee on Fiscal Affairs,[41] is reflected in paragraph 6.1 of the OECD commentary on article 1 of the OECD model tax convention and it is likely, therefore, that Belgium will follow that approach.
(b) See (a) above.

### *2.2.2. Distributive rules*

#### 2.2.2.1. Article 10 – dividends

##### 2.2.2.1.1. Case A

(a) Belgium as state R treats the entity as fiscally transparent and will thus not recognize the "distribution" by P to its shareholders/partners; hence, Belgium should not be obliged to grant a credit for the withholding tax levied in state S. This analysis is in line with the OECD Partnership Report.[42]
(b) Belgium as state R, treating P as fiscally transparent, should exempt from tax the generation of profits at the level of P (e.g. in year x) and therefore would

39 See above, text accompanying notes 16 and 17.
40 OECD Partnership Report, R(15)-54, para. 137.
41 OECD Partnership Report, R(15)-50, para. 127.
42 OECD Partnership Report, R(15)-53, para. 134 *et seq.* See also Peeters, *op. cit.*, p. 575.

not be permitted under the tax treaty provision mirroring article 23 of the OECD model tax convention to tax the profits when earned on the basis that the dividend article of the relevant tax treaty would allow them to be taxed when distributed (in year x + 1) in state S (as state S treats P as a taxable entity).[43]

(c) This is not applicable (see response (b) above).

#### 2.2.2.1.2. Case B

(a) In the *Prince de Ligne I and II* cases referred to above,[44] the Brussels Court of Appeals ruled that if the entity is a legal entity under the laws of state S (*lex societatis*), Belgium should treat the entity as a separate taxpayer even if the entity is fiscally transparent on the basis of state S's tax provisions. Therefore, the initial income allocation to the entity is a non-event for Belgian tax purposes; rather the subsequent (dividend) distribution to the partners would constitute the taxable event for Belgian tax purposes. In that line of reasoning, the conclusion should thus be that article 10 rather than 6 should be applicable to this case. As discussed above, however, based on case law of the Belgian Supreme Court as well as recent rulings with respect to UK LLPs and, particularly, with respect to US real property held by a Belgian resident through a US LLC, it would seem that this position has been abandoned. It is likely, therefore, that Belgium as state R will accept to be bound by the income qualification in state S (real property income within the meaning of article 6 of the OECD model convention) and, hence, will exempt the income under the exemption (for individuals: with progression) method.

(b) See (a) above.

### 2.2.2.2. Article 11 – interest

#### 2.2.2.2.1. Case A

(a) Belgium as state A (i.e. the state of residence of the partners) considers P to be fiscally transparent and, thus, from a Belgian perspective, P is lacking legal personality. Under Belgian law, therefore, P cannot contract a loan implying that the interest payment cannot be allocated to P; rather, each partner should be deemed to have paid the interest "owed" by P in proportion to his/her rights in P state of residence.[45] Since interest is deemed to arise in a contracting state when the payer is a resident of that state (article 11(5) of the OECD model tax convention), and the partners (who are deemed to be the payer of the interest) are resident in state A, Belgium will consider that the interest is sourced in Belgium and that, hence, the applicable treaty is the treaty concluded between state A and state C; Belgium will reduce its withholding tax accordingly.

(b) Belgium as state B treats P as a taxable entity and thus considers that P has legal personality. Under Belgian law, therefore, P is legally able to contract a

43 OECD Partnership Report, R(15)-54, para. 137.

44 See above, note 10.

45 P. Hinnekens, "Belgium", in *International tax problems of partnerships*, *Cahiers de droit fiscal international*, 1995, vol. A, p. 105.

loan and, as a result, the interest payment can be imputed to P. Since P is a resident of state B, Belgium will consider that the interest is sourced in Belgium and, hence, the applicable treaty is the treaty concluded between state B and state C and Belgium will have to reduce its withholding tax accordingly.

(c) Belgium as state C (not being the residence state of P or of the partners) cannot be bound by the entity classification and/or income qualification by states A and/or B. As it treats P as fiscally transparent, only the partners will be considered to be "residents" for tax treaty purposes. Hence, Belgium is likely to only grant a credit for the tax withheld in state A under the A–Belgium tax treaty (subject, however, to the complication of the abolition of the foreign tax credit for individuals not acting in a professional capacity).[46] In the case at hand, the A–Belgium tax treaty should be applicable as state A also treats P as a fiscally transparent entity.

#### 2.2.2.2.2. Case B

(a) See case A(a) in section 2.2.2.2.1.

(b) See case A(b) in section 2.2.2.2.1.

(c) Belgium as state C treats P as opaque and, therefore, a tax credit could only be available under the Belgium–B tax treaty. However, as state B treats P as fiscally transparent, P is not a resident of state B (as it is not liable to tax there) and, hence, the Belgium–B tax treaty cannot be applicable.

#### 2.2.2.2.3. Case C

(a) Belgium as state A considers P to be opaque and thus that P has legal personality. Since P is a resident of state B, Belgium will consider that the interest is sourced in state B and that, hence (article 11 of) the treaty concluded between Belgium and state C cannot be applicable.

(b) Belgium as state B treats P as fiscally transparent and, hence, will consider that the interest is not sourced in Belgium (but is sourced in state A).[47] However, the response will be different if P is engaged in a professional activity and the partners of P are deemed to have a permanent establishment in Belgium. In the latter case, the interest is held to come from the permanent establishment of the debtor of the interest, whether or not such debtor is a resident from a contracting state, if the indebtedness on which the interest is paid was incurred in connection with the permanent establishment and if the permanent establishment bears the interest expense (article 11(5) of the OECD model tax convention). Assuming these conditions are satisfied, the interest would have its source in Belgium and, as Belgium considers the partners as the debtors of the interest, it will have to apply the tax treaty with state C.

(c) Belgium as state C (treating P as transparent) should not be obliged to grant a credit for the withholding tax levied in state B (treating P as transparent and thus considering most likely that the interest is not sourced in state B). An exception concerns the fact pattern where the interest paid is connected with a permanent establishment that the partners are deemed to have in state B, in which case Belgium will have to grant a credit for the withholding tax

46 See above, case A(b) in section 2.2.1.1.

47 See above, case A(a) in section 2.2.2.2.1.

levied in state B. Finally, if state A treats P as opaque, it is difficult to see how state A could levy a (reduced) withholding tax on the interest paid by P (as state A's opaque treatment of P should imply, at least from state A's perspective, that the interest must be deemed to arise in state B).

##### 2.2.2.2.4. Case D

(a) See case C(a) in section 2.2.2.2.3.
(b) See case C(b) in section 2.2.2.2.3.
(c) See case C(c) in section 2.2.2.2.3.

##### 2.2.2.2.5. Case E

In the reporter's opinion, this case study falls outside the scope of the OECD Partnership Report as it concerns an issue of source determination resulting from asymmetrical entity classification by state R and state P in respect of income paid by P *c.q.* the partners to a third-country beneficiary. For the reasons set out in case A(a) in section 2.2.2.2.1 above, it seems unlikely that Belgium would refrain from taxation in the given fact pattern.

#### 2.2.2.3. Article 13(4) – capital gains

##### 2.2.2.3.1. Case A

(a) As Belgium treats P as fiscally transparent, it would normally qualify the sale of "shares" as a sale of the underlying real property, taxable in the state where the real property is located (state S) (article 13(1) of the OECD model tax convention). Thus, Belgium would not treat this as an alienation of shares (article 13(4) of the OECD model convention),[48] because from its perspective there is no entity the shares of which can be alienated. Article 6 of the OECD model tax convention (and the Belgian model), to which article 13(1) refers, contains a reference to the domestic law of the source state for the definition of real property. As a result, Belgium would need to adopt state S's interpretation as to whether the alienation would constitute an alienation of real property or an alienation of shares. The question should be answered in the affirmative if under the laws of state S the alienation of shares in a company principally owning real estate is deemed to be an alienation of the underlying the real property. Logically, the issue is moot in a situation where both states allocate the taxing power to the state in which the real property is located.
(b) The Belgium–R treaty should be applicable.[49] The look-though approach of state R also implies that, for the establishment of the allocation rules under the treaty, the partners are deemed to have sold real property rather than shares, thus principally allocating the taxing power to state S on the basis of article 13(1) of the OECD model. It is reiterated that where, under the OECD Partnership Report, the source state should be considered to be bound by the residence state's entity classification, such is only true for the application of

[48] The Belgian (draft) model convention does not contain a provision similar to art. 10(4) of the OECD model. Rather, the alienation of shares of real estate companies is dealt with under the general rule of art. 10(5) of the OECD model.
[49] See above, case A(a) in section 2.2.1.1 with the nuances mentioned there.

the tax treaty, i.e. for purposes of allocating the taxing power. Once the taxing power has been so allocated, the state applying the treaty can use its own domestic rules to classify/qualify the income.[50] As Belgium treats P as a taxable entity, it will qualify the income as a capital gain realized on an alienation of shares in P. Under Belgian domestic tax law, such gain is not taxable as both the alienator and P are non-residents.[51]

#### 2.2.2.3.2. Case B

(a) See case A(a) in section 2.2.2.3.1 above.
(b) See case A(b) in section 2.2.2.3.1 above.

#### 2.2.2.3.3. Case C

(a) Belgium treats P as a taxable entity (implying that from a Belgian perspective P has legal personality). In the reporter's opinion, therefore, Belgium will (have to) distinguish the income derived through P (alienation of the real property) from the income resulting from the disposal of P (alienation of the entity). In this case study the second income stream (capital gain from alienation) is at stake. Any treaty entitlement and relief available by the partners (if any) in relation to this second income stream must be analysed by reference to the state P–Belgium treaty. In the relation between state P and state R, no income qualification issue should arise because both states treat the entity as a separate taxpayer, resulting in the rules relating to capital gains to be applicable, in this case article 13(5) of the OECD model tax convention because of the bilateralism embedded in article 13(4).[52] In sum, Belgium is likely to consider this an alienation of shares according to article 13(5) of the P–R treaty. As a result, Belgium, being state R, will deem itself competent to tax the income.[53]
(b) The position should be addressed under the Belgium–P treaty (because both state P and state R treat the entity as non-transparent (i.e. they attribute the income solely to P)). In other words, given that state S must follow the approach of state R, treating the entity as non-transparent, the partners cannot invoke the S–R treaty and therefore there is no room to examine the objective qualification in a treaty context under the S–R treaty. Hence (article 13(4) of) the S–R treaty will not apply. Rather the S–P treaty will apply. Because once the taxing power has been allocated, the state applying the treaty can use its own domestic rules to classify/qualify the income and (per the fact pattern) the entity in state P is fiscally transparent pursuant to those rules, Belgium is likely to consider this case with reference to article 6 of the OECD model tax convention in an S–P relationship (i.e. where the entity alienates the real property). As was the case in (a) above, this outcome must again be nuanced with reference to the rulings on UK LLPs, yet this time on the basis of the

[50] Van Bortel, *op. cit.,* p. 58, no. 671
[51] Belgian domestic law does not contain a provision allowing Belgium to tax capital gains on shares of foreign companies owning real estate in Belgium.
[52] The real estate must be located in the other contracting state in order for art. 13(4) to be applicable. This is not the case here: the contracting states are state R and state P while the real estate is located in state S.
[53] In this respect it has to be noted that pursuant to Belgium's domestic tax provisions, in principle, individuals are not taxed on capital gains on shares.

treatment of the foreign partners. As far as the tax treatment of non-Belgian partners on Belgian-source profits of the LLP is concerned, despite the fact that the LLP has legal personality and is therefore a separate taxpayer, the Ruling Commission ignored the separate existence of the LLP by deciding that the foreign partners have a permanent establishment in Belgium, thus granting taxing power to Belgium. Nonetheless, when determining the applicable rules to tax the income, the Ruling Commission again respected the separate existence of the LLP by taxing the Belgian-source profit on the basis of the rules pertaining to non-resident corporations rather than non-resident individuals.

#### 2.2.2.3.4. Case D

(a) As was the case with case C(a) in section 2.2.2.3.3 above, Belgium should judge any treaty entitlement of the partners in relation to the second income stream (disposal of the shares) with reference to the state P–R treaty (where state P is also the state of source) rather than the state S–R treaty. This time, unlike in case C(a), a qualification issue arises because only state R treats the entity as a separate taxpayer, resulting in state R, the state applying the treaty, feeling entitled to tax the capital gain on the basis of article 13(5) of the OECD model tax convention. The question thus remaining is whether Belgium, as state R, has to refrain from taxing this income stream because state P does not recognize it as a separate taxable event. The Belgian (draft) model convention only requires Belgium to provide treaty relief for income regarded as dividends under Belgian law that are derived by a resident of Belgium from a participation in an entity that is deemed a separate taxpayer under Belgian law but is fiscally transparent in the other contracting state.[54] However, here the income is not a dividend but a capital gain, so based on a literal interpretation no treaty relief should be available. On the other hand, to the extent that it may be considered that the OECD Partnership Report principles are adhered to by the Belgian tax authorities, it might well be argued that Belgium should grant relief. Incidentally, this analysis would also seem to find support in paragraph 32.4 of the OECD commentary on article 23.[55]

(b) Belgium is likely to apply neither the S–P treaty (because state P treats P as transparent) nor the S–R treaty (because state R, treating the entity as opaque, does not allocate the income to a resident of state R). As such, Belgium should be able to tax the income without limitation pursuant to its domestic law.

### 2.2.2.4. Article 15(2) – income from employment

#### 2.2.2.4.1. Case A

(a) According to the OECD Fiscal Committee, the concepts of "employer" and "resident" in article 15(2)(b) are to be applied at the level of the partners

[54] Cf. above, section 2.1.

[55] See M. Van Keirsbilck, "Relief from Double Taxation", in *The New USA–Belgium Double Tax Treaty: A Belgian and EU Perspective*, Larcier, Ghent, 2009, pp. 471–472, nos. 22.30–22.33, with references to P. Hinnekens, A. Bax and S. Claes. See also the last example of Circular letter no. AFZ/2004/0053 (AFZ 5/2004) of 16 January 2004.

rather than at the level of the partnership.[56] To the extent that the Belgian-resident partners are so deemed to be the employer (because state P treats P as fiscally transparent), article 15(2) should not be applicable.

(b) See (a) above.

#### 2.2.2.4.2. Case B

(a) For the reason set out in case A(a) in section 2.2.2.4.1, P (treated as opaque in state P) is likely to be considered the employer and, hence, article 15(2)(b) should be applicable.

(b) See (a) above.

### 2.2.2.5. Article 16 – directors' fees

#### 2.2.2.5.1. Case A

(a) For purposes of article 16 of the OECD model tax convention, a company is defined as a "body corporate or any entity that is treated as a body corporate for tax purposes".[57] The assessment should be made in reference to the tax laws of the state in which the entity is organised,[58] an approach that is followed by most Belgian treaties.[59] The income should therefore be taxable in state S and Belgium should exempt it (exemption with progression).

(b) P qualifies as a Belgian-resident corporation and, hence, article 16 of the OECD model tax convention should be applicable.

#### 2.2.2.5.2. Case B

(a) Because P is not liable to tax pursuant to the laws of state S (e.g. because of "check-the-box" regulations), the conditions for application of article 16 of the OECD model tax convention are not met.[60]

(b) Belgium treats P as a transparent entity. Therefore, from a Belgian viewpoint, P has either no legal personality (and is therefore not a "resident" for tax treaty purposes) or P has legal personality, but is nonetheless treated as having no legal personality for tax purposes because of a specific tax provision (article 29, §2 of the ITC). Thus, Belgium should not apply article 16 of the OECD model convention and should not claim taxing power, regardless of the interpretation of state R.

[56] OECD Transparency Report, R(15)-37, para. 91.

[57] Art. 3(1) OECD model convention.

[58] OECD commentary (2010) on art. 3, §3.

[59] L. De Broe and R. Neyt, "General Definitions", in *The New USA–Belgium Double Tax Treaty: A Belgian and EU Perspective*, Larcier, Ghent, 2009, p. 42, no. 3.10.

[60] E.g. in Ruling no. 600.220 of 12 December 2006, the Ruling Commission (in a different context) confirmed that a US LLC, having legal personality but not having checked the box as a corporation (no election for C-Corp treatment), is not to be treated as a corporation in the sense of the (former) Belgium–US tax treaty.

## Canada

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## Summary and conclusions

Canada imposes tax on the worldwide income of each person who is resident in Canada. For Canadian tax purposes, a "person" includes a corporation and a trust, but not a partnership, which is generally treated as fiscally transparent. The characterization of an entity is based on its legal form. It is not possible for a corporation or other person to elect to be fiscally transparent or for a partnership to elect to be a taxable entity.

Canada also imposes tax on the "taxable income earned in Canada" of a non-resident person and withholding taxes in respect of other Canadian source income such as dividends and royalties paid or credited by a person resident in Canada to a non-resident person.

In characterizing a foreign entity for Canadian tax purposes, a two-step process is followed. The characteristics of the entity under foreign private law are determined. The identified characteristics (including legal personality, limited liability, management, perpetual life and free transferability of interests) are then compared with the principal types of business organization under Canadian private law (corporations, partnerships and trusts). Of note, a separate legal entity clause in foreign partnership legislation does not preclude an arrangement from being characterized as a partnership and limited liability is neither a necessary nor sufficient condition to characterize a foreign entity as a corporation. The two-step approach is followed on a case-by-case basis. There is some published guidance from the Canada Revenue Agency (CRA) relating to the characterization of specific foreign legal entities for Canadian tax purposes but no comprehensive list.

While a partnership is not a person, Canada treats a partnership with one or more non-resident partners as a non-resident person for the purpose of the withholding tax imposed on non-resident persons. Similarly, where a partnership pays or credits an amount to a non-resident person, the partnership is deemed to be a person resident in Canada in respect of the portion of that amount that is deductible in computing income from a source in Canada.

Hybrid entities raise numerous issues in relation to the availability of treaty benefits although few of Canada's tax treaties expressly address such entities. The

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