2 November 1976

INCOME TAX PRACTICES MAINTAINED BY BELGIUM

Report of the Panel presented to the Council of Representatives on 12 November 1976

9. Therefore, non-residents are only taxed in Belgium on income obtained or collected by them there. Profits of foreign subsidiaries of Belgium-based corporations are not taxed by Belgian authorities, but are subject to the tax jurisdiction of the foreign country in question.

10. In order to avoid double taxation of sales effected abroad by foreign sales establishments Belgium introduced the principle of tax relief in 1906; the measure was subsequently carried into law in 1919, when income tax was established in Belgium.

11. Income obtained from foreign establishments by resident corporations and which has been taxed abroad is assessed after deduction of foreign tax. Belgian tax is then applied to it at one quarter of the normal rate. Evidence that the profits are both obtained and taxed abroad must be produced. In practice, evidence of foreign taxation is not required in respect of profits obtained through an establishment located abroad, if it draws up separate accounts. The fact that certain constituent elements of income may not be taxable or may be tax free in the foreign country is not generally sufficient justification for refusing to grant the benefit of Belgian tax reliefs.

12. As far as sales through foreign sales subsidiaries (permanent equity holdings) are concerned, Belgian taxes foreign profits therefrom only to the degree that they are actually distributed to the parent corporation. However, in order to remedy the effects of cascading taxation of dividends, dividends derived from subsidiaries which would normally have been taxed are deducted from the tax base of the recipient to the extent of 95 per cent (or 90 per cent for certain holding companies) of the net amount received, grossed up by a deemed movable prepayment of 5 per cent; this system is applicable regardless of the size of the Belgian corporation' s equity holding generating dividends.

13. A provision in Belgium' s Income Tax Code (Article 24), which is of general scope, lays down that transactions between Belgian enterprises directly or indirectly related to an enterprise established abroad shall be governed

be

sale of products for export as

22. Commenting on this reply, the representative of the United States argued that it was the effect and not the intent of the legislation which was important. The fact that the practices of Belgium had been in operation for several years was irrelevant. The language of the 1955 amendments to the General Agreement (which, inter alia, introduced paragraph 4 of Article XVI), and the 1960 Declaration had an obligation to cease to grant any subsidies whether or not the subsidies were granted pursuant to legislation existing in 1974, unless a specific reservation was made.

Inter-company pricing rules

23. The United States representative argued that where the profits of a foreign subsidiary were not taxed the inter-company pricing rules of the country of manufacture would become more important. The United States maintained that tax administrators in Belgium might be willing, in some cases, to allow favourable pricing on export sales and that export companies were permitted simply to declare a 10 per cent mark up on production costs by way of manufacturing profit. This would mean that the distortions created by the tax system became even greater.

24. The representative of Belgium stated that Belgian rules on inter-company pricing were analogous in substance to those laid down in Article 9 of the OECD Draft Double Taxation Convention and made it possible to ensure correct invoicing. The rules had recently been complemented and covered also operations or transactions between Belgian companies and persons or companies - whether or not linked to them - established in

corporation being penalized in the determination of its taxable profits. The representative of Belgium concluded that in no case could the system be deemed an export subsidy since it was simply designed to remove obstacles to investment abroad resulting from double or multiple taxation and since it was furthermore of absolutely general scope.

27. In a counter argument the representative of the United States said that even if some tax was paid by a foreign subsidiary, there was still an exemption to the extent that Belgian tax exceeded the tax paid by the subsidiary.

Relation to the DISC legislation

28. The representative of the United States argued in general that, if the DISC legislation violated the General Agreement, then the tax practices of Belgium which operated to exempt a portion of sales income of exporting firms from direct taxes, must be found to constitute even clearer subsidies in violation of Article XVI:4. Whereas the DISC legislation provided only a deferral, the tax practices of Belgium amounted to a remission or exemption. The United States compared the effects of the principles behind its tax policy regarding foreign source income and the effects of the principles behind Belgium's legislation. It was

located within Belgium were more likely to result in lower export prices and, therefore, were even more clearly prohibited by Article XVI:4.

31. The representative of Belgium maintained that unlike the DISC regime Belgium's tax regime did not allow sales by Belgian corporations or domestic subsidiaries in the foreign market at prices lower than in the domestic market and strictly conformed to Article XVI:4 of the GATT. The tax rate was the same whether sales took place in the foreign or in the domestic market.

B. Article XXIII:2 nullification or impairment of benefits

32. The representative of the United States argued that a prima facie case of nullification or impairment was established where it was determined that the measure complained against violated the General Agreement and that, since the tax practices of Belgium constituted prohibited subsidies within the meaning of Article XVI:4 they had resulted in the prima facie nullification or impairment of benefits accruing to the United States under the General Agreement.

33. The Belgian position was that its practices were not in contravention of the GATT and that there was not, therefore, a prima facie case of nullification or impairment.

Conclusions

34. The Panel started by examining the effects of the income tax practices before it in economic terms. The Panel noted that the particular application of the territoriality principle by Belgium allowed some part of export activities, belonging to an economic process originating in the country, to be outside the scope of Belgian taxes. In this way Belgium has foregone revenue from this source and created a possibility of a pecuniary benefit to exports in those cases where income and corporation tax provisions were significantly more liberal in foreign countries.

35. The Panel found that however much the practices may have been an incidental consequence of Belgian taxation principles rather than specific policy intention, they nonetheless constituted a subsidy on exports because the above-mentioned benefits to exports did not apply to domestic activities for the internal market. The Panel also considered that the fact that the practices might also act as an incentive to investment abroad was not relevant in this context.

36. The Panel also noted that the tax treatment of dividends from abroad ensured that the benefits referred to above were fully preserved.

37. In circumstances where different tax treatment in different countries resulted in a smaller total tax bill in aggregate being paid on exports than on sales in the home market, the Panel concluded that there was a partial exemption from direct taxes. The Panel further concluded that the practices were covered by one or both items (c) and (d) of the illustrative list of 1960 (BISD, 9 Suppl. p. 186).

38. The Panel noted that the contracting parties that had accepted the 1960 Declaration had agreed that the practices in the illustrative list were generally to be considered as subsidies in the sense of Article XVI:4. The Panel further noted that these contracting parties considered that, in general, the practices contained in the illustrative list could be presumed to result in bi-level pricing and that this presumption could therefore be applied to the Belgian practices. The Panel concluded, however, from the words "generally to be considered" that these contracting parties did not consider that the presumption was absolute.

39. The Panel considered that, from an economic point of view, there was a presumption that an export subsidy would lead to any or a combination of the following consequences in the export sector: (a) lowering of prices, (b) increase of sales effort, and (c) increase of profits per unit. Because Belgium was an important supplier in certain export sectors it was to be expected that all of these effects would occur and that, if one occurred, the other two would not necessarily be excluded. A concentration of the subsidy benefits on prices could lead to substantial reductions in prices. The Panel did not consider that a reduction in prices in export markets needed automatically to be accompanied by similar reductions in domestic markets. The Panel added that the extent to which tax havens existed was well known and that they considered this some evidence of the extent to whic