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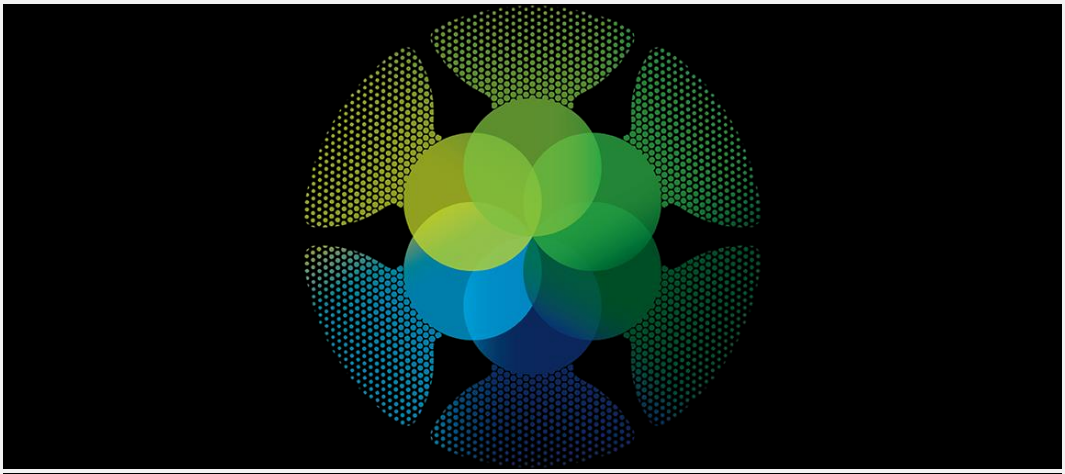
Belgium | Deloitte Tax | 26 November 2020



Global Employer Services
Individual tax

Tax audits on pension commitments may trigger personal tax liability for self-employed directors

The tax authorities are increasingly scrutinising pension commitments by companies to their self-employed directors. Under certain circumstances, such audits may also lead to a personal tax liability for a director.

Companies can commit to provide a pension to their self-employed directors. Before 2012, employers only needed to book a balance sheet provision to fund the pension promise (hereafter "*internal pension promise*").

Since 2012 however, such pension commitments should be managed by an external pension provider, i.e. an insurer or a pension fund (hereafter "*external pension commitment*").

Internal pension promises

According to transitional measures introduced at the time, internal pension promises could remain in place for up to the balance sheet provision amount at 31 December 2011. In short, the tax treatment of the balance sheet provisions can be described as follows:

- The provisions are tax exempt for the company. Upon retirement, the pension is deductible in determining the company's tax base;

- The balance sheet provisions are not taxable for the director. Taxation is deferred until pension distribution.

To benefit from this favourable tax treatment, specific conditions should be met, including compliance with the 80% limit at all times. The part of the balance sheet provisions exceeding this limit will not be tax exempt for the company. Also upon retirement, the distribution will only be tax deductible for the company while within that same limit.

External pension commitments

The tax authorities are also targeting external pension commitments.

Pension contributions in the framework of an external pension commitment should benefit from the following tax treatment:

- The contributions are deductible for the company while within the 80% limit;
- The contributions should remain exempt from income tax for the director.

To ensure contribution tax deductibility for the company and the tax exemption for the director, the contributions should relate to a regular and monthly salary paid to the director.

Accordingly, the importance of the latter condition is twofold:

- If the director does not receive a regular and monthly salary, the pension premiums are immediately taxable as salary for the director;
- If the director does receive a regular and monthly salary, it should be high enough to ensure compliance with the 80% limit.

Director’s personal tax liability at stake

Issues typically relate to scenarios where company directors reduce or end their professional activities within the company, resulting in a significant reduction or complete stop in salary.

In addition, the tax authorities have equally expressed suspicion in scenarios where a salary merely consisted of benefits in kind such as a company car, or when benefits are granted through a bank current account.

In that respect, it is important to note that audits relating to compliance with the above mentioned tax rules may occur every year a tax benefit related to the pension commitment is claimed. This benefit could either be a tax deduction, reduction and/or exemption.

This includes the transformation of an internal pension promise to an external pension commitment, when a pension premium is paid to an external pension provider. Such premium will need to comply with the 80% limit and will also need to relate to regular and monthly salary payments.

Where in the past this may have remained (largely) under the radar, the exchange of information between the II pillar pensions database ("*DB2P*") and the tax authorities have accelerated actions by the latter.

These actions should serve as a motivation to proactively investigate whether pension commitments are compliant with the specific conditions. This would ensure a beneficial tax treatment for the company and would certainly prevent the director from being held personally liable in paying taxes on pension contributions.

Contacts

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