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Operational Tax News

Belgian circular on the deductibility of expenses for the purposes of the computation of the taxable income per share

22 May 2018

Introduced on 9 May 2018 by the Belgian tax authorities, the circular 2018/C/55 (hereafter "**the Circular"**) outlines the deduction methods for expenses incurred by investment funds considered as "in scope" of article 19bis Belgium Income Tax Code 1992 (hereafter "**CIR 92**").

Belgian circular on the deductibility of expenses for the purposes of the computation of the taxable income per share

According to article 19bis CIR 92, the interest component embedded in the proceeds received upon sale, transfer or redemption of shares or units of "in scope" investment funds must be considered as movable income for Belgian income tax purposes and be subject to the Belgian withholding tax on movable income ("précompte mobilier") at a rate of 30%. "In scope" funds are those investing more than 10% of their assets in debt claims.

The Circular clarifies the computation methods related to the interest component (commonly referred to as the "**TIS**" for Taxable Income per Share), more specifically, the conditions for the deduction of certain expenses incurred directly or indirectly by the fund.

Types of expenses

The Circular makes the distinction between expenses that are directly related to debt claims (e.g. write-offs, capital losses, forex losses, etc. related to debt claims) and indirect expenses (e.g. management fees, audit fees, certain taxes, etc.). Unfortunately, the Circular does not provide detailed guidance with respect to the classification of expenses or the allocation of expenses incurred at the umbrella or sub-fund level between various share classes.

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Deductibility rules

The Circular goes on to specify the basic rules governing the deductibility of expenses:

- Direct expenses related to investments in debt claims are fully deductible. Expenses related to investments in underlying funds (in fund of funds or master-feeder structures) are deductible proportionally to those underlying funds' investments in debt claims. Expenses related to investments in non-debt instruments such as equities, certain derivatives, etc. are not deductible.
- The deduction of indirect expenses will be limited to the proportion of the fund's assets invested in debt claims. Such proportion can be determined:
  - On the basis of the fund's investment policy as defined in the prospectus or the management regulations; or
  - On the basis of the actual composition of the fund's portfolio (determined by the calculation of the so-called "**Asset Test**" percentage).

Interestingly, the Circular clarifies that the Asset Test percentage can be determined either annually (based on the most recent semi-annual and annual reports) or at each NAV calculation date (based on the actual composition of the portfolio at each NAV calculation date). Only the former method has been described as acceptable in previous circulars. The latter method is being referred to in the Circular as the Indirect Cost Asset Test ("**ICAT**").

Evidence to provide to the Belgian tax authorities

The Circular also specifies that the fund must be able to justify and to provide evidence with respect to the deduction methods applied, upon request from the Belgian tax authorities.

Example

A fund invests in three asset classes:

- Direct investments in equities (€100);
- Direct investments in bonds and other debt claims (€100);
- Investment in an underlying fund whose asset test percentage is 50% (€100).

The fund has the following NAVs and expenses:

- NAV as of 04.01.2017: €300
- NAV as of 05.01.2017: €312.50
- Indirect expenses: €2.50

The €12.5 increase is NAV is due to:

- An increase of €10 in the value of the equities, partially offset by €3 in direct expenses;

- An increase of €3 in the value of the bonds and other debt claims, partially offset by €1 in direct expenses;

- An increase of €6 in the NAV of the underlying fund; and

- (Indirect) expense of €2.5.

	Stocks	**Bonds**	**Underlying Fund**
Asset Value as of 04.01.2017	100	100	
Direct expenses	3	1	
Asset Value as of 05.01.2017 *(net of direct*	107	102	
NAV as at 04.01.2017			100
NAV as at 05.01.2017			106
Asset Test			50 %
NAV impact before deduction of indirect costs	7 *= (107 - 100)*	2 *= (102 - 100)*	6 *= (106 - 100)*
TIS impact before deduction of indirect costs		2 *= (102 - 100)*	3 *= (6 x 50 %)*

Indirect costs are deducted based on the ratio of the value of the assets invested directly or indirectly in receivables (net of direct costs) on the NAV (gross of indirect costs). This ratio is determined at each NAV computation date.

As of 05.01.2017, the amount of indirect costs deductible from the TIS is determined as follows:

- ICAT: [(0 + 102 + 53) / 315] = 49.21%
- Indirect deductible costs: (2.50 x 49.21%) = 1.23

As of 05.01.2017, the following TIS values will be observed:

- TIS before deduction of indirect costs: (2 + 3) = 5
- TIS after deduction of indirect costs: (5 - 1.23) = 3.77

Industry impacts

The Circular provides much needed clarification with respect to the deductibility of certain expenses for Belgian TIS calculation purposes. Overall, the Circular seems to favor investors as almost all expenses can be (partially) deducted, thereby reducing the amount of taxable income in the hands of the investors. Another positive is that the Circular is expected to bring much needed consistency in the way various management companies and asset servicers compute the Belgian TIS.

Luxembourg management companies and asset servicers that assist investment funds in calculating their Belgian TIS figures may need to review and update their calculation models to ensure that the deductibility of expenses is correctly implemented and in line with the Circular. In addition, management companies should ensure that supporting evidence describing the calculation methodology is readily available and can be shared with the Belgian tax authorities upon request.

Do not hesitate to contact us should you need any information on the above.

Your contacts

Eric Centi
Tax - Global Financial
Services Industry
Tel : +352 45145 2162
ecenti@deloitte.lu

Nenad Ilic
Director
Tax - Global Financial
Tel : +352 45145 2046
neilic@deloitte.lu

Jacquou Martin
Managing Director
Pan-European Tax Services
Tel : +352 45145 2174
jacmartin@deloitte.lu

Deloitte Luxembourg
560, rue de Neudorf
L-2220 Luxembourg

Tel: +352 451 451
Fax: +352 451 452 401
www.deloitte.lu

Designed and produced by MarCom at Deloitte Luxembourg