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New tax rules will have major impact on M&A transactions

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The Belgian legislator has introduced various new tax measures which are part of the implementation of the major corporate income tax reform decided on in December 2017. These new tax measures will enter into force as of January 1, 2019. Two specific new tax rules will have a significant impact on the structuring and the tax consequences of M&A transactions: the new tax consolidation regime and the new interest limitation deduction rules.

Corporate income tax consolidation

Belgium has had no corporate income tax consolidation so far, but only VAT grouping. As of January 1, 2019, however, a corporate income tax consolidation between companies will be possible (new article 205/5 Income Tax Code – "ITC").

Belgian companies, foreign companies (if established in the European Economic Area) as well as Belgian branches of foreign companies can participate in the new tax consolidation. However, only "connected" companies qualify for the purposes of the new consolidation regime, which connection requires a direct participation of at least 90% or a participation of at least 90% in each connected company through a direct intermediary holding company. Further, the consolidation regime requires that the companies concerned have been qualified as connected companies for an uninterrupted period of at least 5 years.

If the consolidation conditions are fulfilled, the consolidation regime will allow a profit-making company to attribute a so-called tax-deductible "group contribution" to a loss-making company. This group contribution can be fiscally compensated with the current year's tax losses of the contribution-receiving company. For the purpose of the application of the tax consolidation, the connected companies will need to conclude a so-called "group contribution agreement" which applies for a specific tax year.

As of next year, it will therefore be possible to implement a tax consolidation between a HoldCo and a TargetCo, if the above conditions are fulfilled. It should be noted that the minimum five-year shareholding period implies that the new consolidation regime will only become effective on new acquisitions or M&A transactions in the medium or longer term. On the other hand, the new consolidation rules can be applied on existing structures complying with the above conditions. In any case, the new rules will allow an effective consolidation and will certainly offer an alternative to the existing tax-planning measures, aiming to fiscally compensate profits and losses of various group companies (management fees, merger operations, etc.).

Another new tax rule which is highly relevant for M&A transactions is the new interest deduction limitation.

Interest deduction limitation

The new interest deduction limitation executes on a Belgian level article 4 of the EU Anti-Tax Avoidance Directive of July 12, 2016 (ATAD), by limiting the tax deduction of interest expenses and similar finance costs. In this respect, article 198/1 ITC introduces into Belgian tax legislation the notion of "finance costs surplus" ("FCS"), as a result of which the net interest costs can only be tax deducted up to the highest of the two following thresholds:

- 3 million EUR, *or*
- 30% of the EBITDA of company.

The FCS is calculated by the positive difference between on the one hand the total amount of interest costs (or similarly qualifying costs) which are tax deductible and on the other hand the total amount of interest income (or similarly qualifying income). Interest costs and interest income connected to a foreign permanent establishment which is tax exempt on the basis of a Tax Treaty are not considered.

The EBITDA is calculated by increasing the taxable result of a specific tax year with the tax deductible depreciations and amortizations and with the deductible part of the FCS itself and by decreasing this balance with certain types of income (such as deductible dividend income, the tax-deductible consolidation group contribution, income exempted on the basis of a Tax Treaty, etc.).

The new rule applies on Belgian companies and on Belgian branches of foreign companies.

It is important to note that in the case of group companies the 3 million EUR threshold, the applicable 30% - EBITDA threshold as well as the FCS itself are calculated on a consolidated basis. At the same time, it will be possible to conclude an "interest deduction agreement" between group companies, as a result of which the non-consumed FCS balance can be transferred to another group company.

Also, certain existing deduction rules applying to interest which is paid out to beneficiaries in offshore locations (art. 54 ITC) or which is considered not to be "at arm's length" (art. 55 ITC) will remain applicable. Also, the interest connected to loans concluded before June 17, 2016 and which have not been subject to "fundamental modifications" will escape the application of the new interest deduction limitation. Finally, the existing intra-group debt/equity deduction limitation rule of 5 (Debt) on 1 (Equity) will in the future continue to apply to interest paid to beneficiaries in offshore or low-tax jurisdictions and to loans between group companies which have been concluded before June 17, 2016 and which have not been subject to fundamental modifications.

In any case, the interest deduction limitation rule will have a significant impact on the tax treatment of finance costs of the acquisition of a participation in another company: these costs will in the future no longer be totally deductible, but will need to meet the 30% - EBITDA or the 3 million EUR maximum thresholds test. Considering the 3 Mio EUR threshold, a full tax deduction of the net finance costs not exceeding the latter amount is allowed in any case (and regardless of a lower 30% - EBITDA threshold), it is clear that many small- or medium-sized acquisitions will fall outside the scope of the new tax measure. Larger acquisitions will more frequently be subject to the 30%- EBITDA threshold (which applies if the net finance costs exceed 3 million EUR) and may therefor consider a higher equity funding, in order to avoid being confronted with on the one hand taxable finance income at creditor's level and on the other hand (at least partially) non-deductible finance costs at debtor's level.

These two new tax measures will require even more careful tax planning of an M&A transaction, in order to limit its overall tax cost and in order to seize the opportunities or avoid the pitfalls of the new rules.