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The Belgian Federal Parliament recently adopted a new controlled foreign corporation provision, known as the ''Cayman tax,'' that allows Belgian tax authorities to look through low-taxed offshore structures to directly tax their Belgian resident founders and third-party beneficiaries on the structure's income. Belgium's introduction of the Cayman tax is in line with the international trend toward increased scrutiny of offshore legal structures that are merely aimed at lowering the tax burden of the founders or controlling shareholders. The Cayman tax may face practical issues, however, and it is unclear how it will interact with international tax principles and European Union law.

As a means of tackling tax evasion and tax avoidance, Belgium introduced the so-called Cayman tax as part of a wider package of tax measures in the Program Law of August 10, 2015.[1] The Cayman tax targets private investment entities set up in low-tax foreign jurisdictions — such as the Cayman Islands — by Belgian resident private individuals and certain legal entities. Under the new regime, Belgian tax authorities can look through targeted offshore structures to directly tax founders and third-party beneficiaries on income earned by those structures. As such, the Cayman tax is the first controlled foreign corporation provision to be adopted by the Belgian legislature.

[1]Published in the Belgian official gazette on August 18, 2015.

Scope

Targeted Taxpayers

The new Cayman tax rules apply exclusively to Belgian resident private individuals and legal entities that are subject to Belgium's income tax on non-corporate legal entities.[2] Notably, the tax does not apply to Belgian resident corporations.

Both the founders and the third-party beneficiaries of targeted foreign legal structures are subject to the Cayman tax. The term ''founder'' is broadly defined to include not only the legal founders of the entity and their heirs[3] but also those that have transferred assets to it and those that hold legal or economic rights to the structure or its assets.

Targeted Structures

The Cayman tax targets two categories of structure, namely:

- fiduciary agreements, such as trusts and other structures without legal personality (Category A structures); and
- foreign legal entities (including foundations) that are not subject to corporate income tax or that are subject to a regime that is substantially more beneficial than the ordinary Belgian corporate tax regime (Category B structures).

Foreign corporate income tax regimes are deemed to be substantially more beneficial than Belgium's if they subject the entity to an effective corporate tax rate of

[2]For example, nonprofit organizations.

[3]Unless they are able to prove that their heirs will never draw any benefit from the structure.

less than 15 percent. To determine the effective corporate tax rate, the foreign entity's taxable base is recomputed in accordance with Belgian tax rules.[4] This computation is repeated annually, with the result that entities may be subject to the Cayman tax in some years but not others.

Specific types of entities that are subject to the Cayman tax are listed in two royal decrees dated August 23, 2015.[5]

The first list relates to entities established within the European Economic Area[6] and includes three types of entity: the Liechtenstein *stiftung*, the Liechtenstein *anstalt*, and the Luxembourg *société de gestion de patrimoine familiale* (SPF). This list is exhaustive, although it may be updated or amended. Entities of a listed type will be irrefutably presumed to benefit from a corporate tax regime that is substantially more beneficial than the Belgian regime.

The second list relates to entities established outside the EEA and is non-exhaustive. Listed entities will be subjected to the Cayman tax unless they can provide evidence that they are subject to an effective tax rate of at least 15 percent. Sixty-six types of entities are listed, most notably:

- international business companies in the Bahamas, Barbados, Belize, the Marshall Islands, Panama, and Seychelles;
- exempt companies in Bermuda, the Cayman Islands, and the U.S. Virgin Islands;
- companies in the British Virgin Islands, Costa Rica, Guernsey, Guam, the Isle of Man, Jersey, and Micronesia;
- foundations in the Bahamas, Guernsey, Jersey, Monaco, and Switzerland;
- international societies with restricted liability in Barbados;
- global business companies (categories 1 and 2) in Mauritius;
- *fundaciones de interés privado* in Panama;
- private limited companies in Hong Kong;
- offshore companies in the United Arab Emirates; and
- limited liability companies based in the U.S. states of Delaware and Wyoming.

Companies that are listed on a regulated stock exchange, public and institutional collective investment undertakings, and pension funds are expressly excluded from the application of the Cayman tax. Active entities with sufficient substance that are established within the EEA or in a country that has concluded a bilateral or multilateral exchange of information agreement with Belgium are also excluded. Entities are considered to be active for this purpose if they carry out a genuine economic activity in their country of establishment and their premises, personnel, and equipment are proportionate to their economic activity.

Application: Look-Through Taxation

The Cayman tax provides for a legal presumption that the founders of a targeted legal structure are the direct beneficiaries of its income. Consequently, founders can be taxed on the targeted structure's income as if they had received it directly, regardless of whether the structure has distributed any of its income to its founders or shareholders.

The classification of income and its corresponding tax treatment remain unaffected by the Cayman tax, however. For example, dividends, interest, and capital gains on shares received by the legal structure will continue to be categorized as such for tax purposes, and the founders will be taxed accordingly. The same rule applies to real estate income, professional income, and miscellaneous income earned by the legal structure.

Preventing Double Taxation

As previously noted, the Cayman tax applies regardless of whether the legal structure has actually distributed any of its income to founders or shareholders. To prevent double taxation occurring if income is in fact distributed, Belgian tax law provides that distributions are exempt from further taxation if the income has already been taxed on the basis of the look-through rules.

Double taxation may also occur when income that is subject to the Cayman tax is distributed to a beneficiary other than the founder, as the founder and beneficiary may be taxed on the same income. The Cayman tax rules therefore allow founders to demonstrate that the income has been granted to one or more other beneficiaries that are established in an EEA member state or in a country that has concluded a bilateral or multilateral tax information exchange agreement with Belgium. If the founder provides sufficient evidence to this end, he will not be taxed on such income; if the beneficiary is a Belgian resident for tax purposes, the beneficiary will be taxed on the income.

No Foreign Tax Credit

Foreign taxes paid by targeted offshore entities cannot be credited against any Belgian income tax due from their founders or beneficiaries. Ironically, the absence of a foreign tax credit means that offshore structures in tax havens may be treated better under the Cayman tax than entities that are subject to low rates of taxation in bona fide jurisdictions.

[4]Specific Belgian incentives will be taken into account, such as the notional interest deduction, the patent income deduction, and the Belgian participation exemption, as will restrictions such as the Belgian thin cap rules on interest deduction.

[5]Published in the Belgian official gazette on August 28, 2015.

[6]EEA member states include the 28 EU member states plus Iceland, Liechtenstein, and Norway.

Antiabuse Provisions

The recent Program Law also contains a broad and open-ended antiabuse provision that allows Belgian tax authorities to disregard legal acts of Category B structures that are aimed at circumventing the application of the Cayman tax rules.

The law also contains a specific antiabuse provision under which any changes to the articles of incorporation of Category B structures made on or after October 9, 2014, with a view to transforming them into Category A structures are not enforceable vis-à-vis the Belgian tax administration. This measure is aimed at preventing conversions that take place for the sole purpose of avoiding taxation upon liquidation.[7]

Entry Into Force

The Cayman tax applies to income earned by targeted offshore structures as of January 1, 2015, as well as to income earned earlier but distributed or paid by the legal structure as of the aforementioned date.

Conclusion

The introduction of the Cayman tax is in line with the international trend toward increased scrutiny of offshore legal structures that are merely aimed at lowering the tax burden of the founders or controlling shareholders. For the past few years, Belgian resident individual taxpayers have been obligated to report offshore legal structures in their annual personal income tax return. By introducing the Cayman tax, the Belgian legislature has opted to delineate actual tax consequences for individuals or entities that set up or benefit from these structures.

Although the look-through taxation principle of the Cayman tax is simple, some features may cause practical issues. For instance, the re-computation of offshore companies' taxable bases in accordance with Belgian standards — that is, to determine whether the company is subject to an effective tax rate of at least 15 percent — is likely to be a difficult and complex exercise.

Another negative aspect of the Cayman tax is that it does not entirely prevent double taxation if founders are unable to demonstrate that distributions were made to beneficiaries other than themselves or to provide evidence of the exact amounts of those distributions. The Cayman tax rules also do not grant credits for any income tax actually incurred by the relevant structure, which may trigger tax leakage.

Further, some legal scholars have suggested that the current rules may be contrary to the principles of the EU and, more particularly, to a recent ruling by the European Free Trade Association Court.[8] It is likely that one or more Belgian taxpayers will be tempted to test this reasoning in court. ◆

[7]Only Category B structures are subject to taxation upon liquidation.

[8]E-3/13 and E-20/13, *Olsen and others v. Norway*, [2014] EFTA Court Report.