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Global Tax Alert

Belgian Government proposes temporary carryback of losses and special tax-exempt reserve in response to COVID-19

Executive summary

A draft law is currently under consideration by the Belgian Government to introduce the possibility for companies to carry back the losses incurred during the COVID-19 crisis to offset the taxable profits of the previous financial year. A "recovery reserve" would also be introduced, allowing companies to reduce their profits for tax years 2022, 2023 and 2024 by creating a tax-free reserve up to the amount of the losses incurred in 2020.

These fiscal stimulus initiatives are still draft proposals and therefore may ultimately be amended if and when introduced. The provisions of the current proposal are outlined below.

Detailed discussion

The carryback of losses

In Belgium, tax losses can only be carried forward and no mechanism allows for a carryback to previous tax years. As an exception to this rule, the Belgian Government is considering introducing a one-time carryback rule as a COVID-19 fiscal stimulus. The proposed rule would allow companies to deduct the **estimated tax loss** of the current financial year (i.e., the COVID-19 Year) from the taxable profit of the tax year preceding the COVID-19 Year (i.e., the

Deduction Year). This would reduce the taxable basis and tax due in the Deduction Year and effectively achieve a carryback. It is not a carryback of a final determined tax loss but of an estimate thereof.

The amount deducted would be added to the tax base in the COVID-19 Year and be offset by the actual loss realized in that year. Technically, this would be realized through a reserve in the tax return.

The Deduction Year can be any financial year ending between 13 March 2019 and 12 March 2020. The COVID-19 Year is the financial year following the Deduction Year.

Companies preparing their tax return for the previous year (e.g., the financial year closing on 31 December 2019) will need to estimate the loss they expect to make in the COVID-19 Year. In any case, the carryback cannot exceed the taxable profit of the Deduction Year. If there is no taxable income in the Deduction Year, no carryback can be applied. If the tax return of the Deduction Year has already been filed, an adjustment will need to be filed.

If the losses of the COVID-19 Year have been over-estimated by more than 10% and the taxation of the deducted amount results in a taxable profit in the COVID-19 Year, a special surtax will apply at a rate of 2% to 40%, depending on the relative scale of the deviation. The surtax will apply on the amount of the taxes that are due on the profit that is in excess of the 10% margin of error.

If there is a change in the applicable tax rate between the Deduction Year and the COVID-19 Year, an adjustment mechanism would be applied so that the tax on the amount is the same. This adjustment can also have an impact on the amount that can be deducted.

Different from the utilization of carried forward tax losses, no 30% limitation on the utilization of these tax losses seems to be considered.

Some important conditions and limitations apply:

- The company **may not have executed any form of reduction or distribution of equity** (including a buy-back of the company's own shares) between 12 March 2020 and the filing of the tax return for tax year 2021.
- The carry back cannot exceed €20 million.
- Companies subject to specific tax regimes such as investment companies or companies that benefit from the shipping tax are excluded.
- Companies that directly hold shares in companies located in tax havens are also excluded.
- Companies that make annual payments of at least €100k to tax havens are excluded unless it is demonstrated that these payments are made in the framework of real and sincere transactions that correspond to legitimate economical or financial needs.

The recovery reserve

In addition to the carryback of losses, companies will be allowed to exempt taxable income in the following three taxable years via a so-called recovery reserve. Note that this is not a permanent exemption as the exemption is achieved through the creation of a tax-free reserve, and specific events may trigger taxation in the future.

This mechanism allows the creation, during tax years 2022, 2023 or 2024 (i.e., for financial years following the calendar year – respectively financial years 31 December 2021, 31 December 2022 and 31 December 2023) of a tax-free reserve that would reduce the taxable profit of that tax year. The recovery reserve cannot exceed the operational loss of the financial year closed in 2020. An exception would apply for companies closing between 1 January 2020 and 12 March 2020 in which case it is the loss of the accounting year closed in 2021 that can be used.

The amount allocated to this reserve in a specific year cannot exceed the reserved taxable profits of that year and must be booked in a specific equity account.

The same conditions and limitations apply as for the carryback mechanism.

Where conditions would no longer be met, taxation of the recovery reserve would occur. In some cases, the taxation of the recovery reserve as a result of the conditions no longer being met, would only be partial. This would be the case for equity reduction/distribution and buy back of own shares in which case the taxation of the reserve is proportionate.

Finally, it is important to note that the tax-free character of the reserves would be forfeited where there is a reduction in the salary charges of the company. If the amount of salary charges as recorded in the accounts of the Belgian company drops below 85% of the amount that was booked in the accounts closed in 2019, the recovery reserve becomes taxable up to the amount of the reduction.

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