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Global Tax Alert

Belgium issues Circular letter clarifying "grandfathered loans" under new interest deduction limitation rule

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At the end of 2017, as part of its corporate income tax reform, Belgium transposed the first European Union (EU) Anti-Tax Avoidance Directive (ATAD 1) which provides for a new interest deduction limitation rule into Belgian domestic tax law.[1] Pursuant to this interest deduction limitation rule, the deduction of net interest charges is limited to the higher of: (i) €3 million; and (ii) 30% of the taxable EBITDA.[2] The entry into force of the limitation rule was initially scheduled for 2020 but was advanced to 2019 (financial years starting on or after 1 January 2019) last year in order to fully comply with the ATAD 1 and to avoid potential action from the European Commission.

The new rules provide for the grandfathering of loans concluded before 17 June 2016 which have not been fundamentally modified after the grandfather date. These grandfathered loans remain subject to the 5:1 thin capitalization rules (if applicable). A new Circular letter, issued by the Belgian Tax Authorities on 11 September 2019, now clarifies the notion of "fundamentally modified." Depending on the particular situation, a modification of the contracting parties, the interest rate, term of the loan or principal amount loaned, will qualify as a fundamental modification. Refinancing an existing loan will likewise be considered as a fundamental modification. More generally, any kind of debt renewal (novation) as described by art. 1271 of the Civil Code or by a similar foreign provision will also qualify as a fundamental modification.

Although the Circular letter allows further evaluation of every particular situation, it identifies a number of fundamental modifications and non-fundamental modifications as set forth below.

Fundamental modifications

The following modifications are deemed "fundamental" irrespective of whether there is an (explicit) agreement or consent of (one or more) of the parties involved.

- A modification of the term of the loan not contractually foreseen prior to 17 June 2016
- A modification of the interest rate not contractually foreseen prior to 17 June 2016
- A modification of the principal loan amount
- A modification of the interest calculation not contractually foreseen prior to 17 June 2016
- A modification or replacement of one or more of the initially involved parties except for a modification or replacement of the original lender which was already contractually foreseen prior to 17 June 2016
- Any modification imposed by the legislator or a supervising authority

Non-fundamental modifications

The Circular letter sets out a non-exhaustive list of examples of modifications that do not impact the grandfathering of a loan.

- Minor administrative changes such as the modification of a bank account number
- A name change or change of the legal form of one of the contracting parties
- An address change of one the contracting parties
- A modification to the term of the loan contractually foreseen prior to 17 June 2016 and resulting from an automatic extension
- A modification of the interest rate contractually foreseen prior to 17 June 2016
- Modifications to the interest payment modalities (e.g., quarterly payment instead of monthly)
- A modification to the original security
- A drawdown under a facility agreement as from 17 June 2016 relating to loans concluded prior to that date

A fundamental modification to a loan as from 17 June 2016, that would in principle have been entitled to grandfathering, results in an entire loss of the grandfathering. All interest relating to the period as from the fundamental modification will fall into the scope of application of the new interest deduction limitation rule.

However, the Circular letter does not clarify a number of conceivable scenarios e.g., whether cash pool arrangements can be grandfathered, whether the relocation of a contracting party to Belgium constitutes a material modification, etc.

For the sake of completeness, it must be noted that certain key elements of the EBITDA interest deduction limitation rule still need to be implemented before year-end 2019 (e.g., the definition of expenses and income equivalent to interest, the allocation key to divide the €3 million threshold among the Belgian group entities).

Endnotes

1. See EY Global Tax Alert, *Belgian Parliament adopts corporate tax reform*, dated 2 January 2018.
2. Earnings before interest, taxes, depreciation and amortization.

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