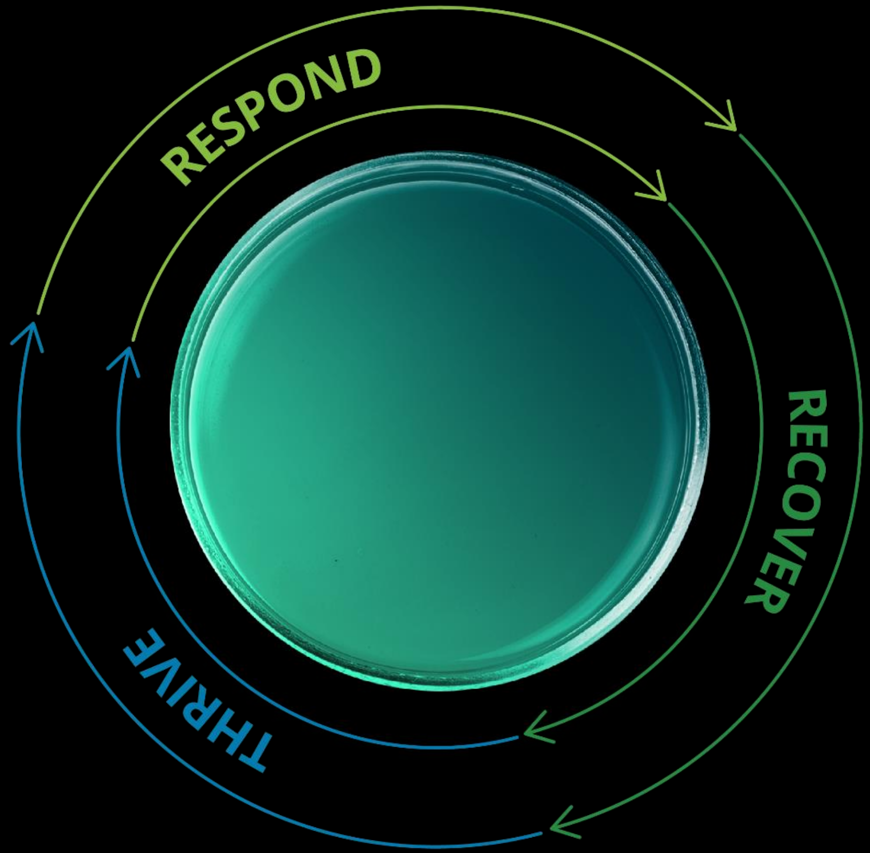

Webinar: COVID-19 Government Support measures “Loss carry-back reserve” & “Recovery reserve” Applicable to the diamond industry

17 July 2020

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Corona packages in process

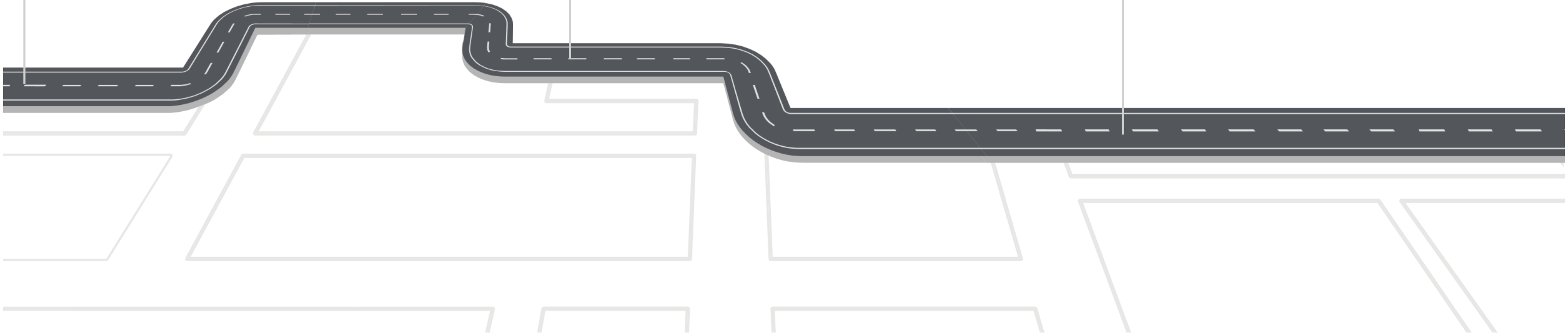
New tax measure: Loss carry-back (Law Corona II)

Bill 1309
Adopted by Parliament

Recovery Reserve

Law proposal 1412
Re-introduced on 2 July 2020
Approved by Finance Commission on 7 July 2020

New measures in the pipeline (Corona III)



Law Corona II

- Loss carry-back reserve

Loss carry-back reserve

Overview

Carry back effect

- This measure allows companies to offset **taxable profits** of tax years 2019 or 2020 (i.e. relating to financial years closed between 13 March 2019 and 31 July 2020) with **accounting losses** (expected to be) incurred in the subsequent tax year (i.e. respectively tax year 2020 or 2021).
- Aim is to strengthen the financial position of the companies affected by COVID-19 outbreak:
  - Reducing the income tax liabilities for tax year 2019 or 2020
  - Claiming a refund for income tax already settled (or being exempt from making (additional) payments).

In practice

- The benefit is granted through the creation of a tax exempt reserve in the tax year for which the taxpayer elects to apply the measure (optional).
- The losses carried back should be recaptured in the tax base of the subsequent year to avoid any double deduction.
- The carry-back is limited to one year (e.g. taxable period per 31 March).

FY closed 31/12/2019

Result of the year

100 (**taxable profit**)

CIT for TY 2020 without loss carry-back

100*29.58% = **29.58**

CIT for TY 2020 with loss carry-back

(100 - 100)*29.58% = **No CIT due**

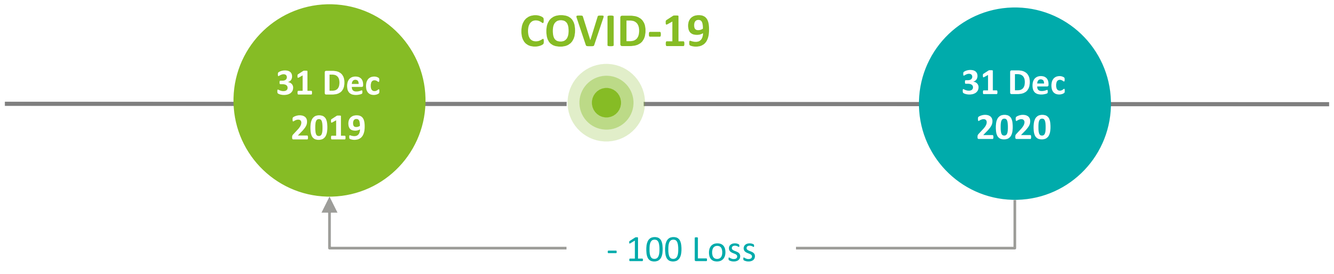
FY closed 31/12/2020

Result of the year

-200 (**accounting losses**)

CIT for TY 2020

(-200 +100)*25%= **No CIT Due**



Loss carry-back reserve

Conditions, exclusions and anti-abuse provisions

Maximum carry back

The **temporary tax-free reserve** cannot exceed the result of the taxable period after the so-called "first operation" (i.e. the total of the taxable reserves including the application of the Diamond Regime, dividends and disallowed expenses*)*, subject to two adjustments, i.e. the result must be:

- determined as if the exemption would not have been requested, and reduced by the amount of the current year dividends, innovation and patent income that benefit respectively from the DRD, IID and PID regime; and
- the reserve will in any event be capped at a maximum amount of EUR 20,000,000.

Recapture of tax exempt reserve

The **recapture** of the tax exempt reserve is **increased** in order to neutralize the shift of profits taxable at a more beneficial income tax rate the subsequent year (e.g. 29.58% for financial year 2019 *vs.* 25% for financial year 2020).

Overestimation of carry-back loss

Taxpayers need to (carefully) estimate the expected accounting loss to carry back; in case of overestimation:

- by less than 10%: recapture, but **no penalty**
- by more than 10%: recapture and **penalty** (ranging from 2% to 40%)

Exclusions

- Companies with a **special tax regime**: investment companies, pension financing organizations, cooperative holding companies, companies subject to "tonnage tax".
- Companies **in distress on 18 March 2020** ("ondernemingen in moeilijkheden" or "entreprises en difficulté").
- Companies that have made a dividend distribution, share buyback, capital reduction or other equity distribution **(as of 12 March 2020 up to and including the filing date of the tax year 2021 tax return)** – cf. infra.
- Companies that have **a substantial link with tax havens**:
  - Hold direct shareholding in a company established in a tax haven; or
  - Make payments (>EUR 100,000) to companies established in a tax haven, unless it has been demonstrated that these payments were made in context of real and sincere operations resulting from legitimate financial or economic needs.

Loss carry-back reserve

Increase of the recapture

Beginning of the tax year in which the loss carry-back reserve is claimed	Beginning of the tax year in which the loss carry back reserve is recaptured	**Increase of the recapture %**
Before 1/1/2018 (33.99%)	After 1/1/2018 (29.58%)	**14.91%**
After 1/1/2018 (29.58%)	Before 1/1/2020 (29.58%)	**0%**
Before 1/1/2020 (29.58%)	After 1/1/2020 (25%)	**18.32%**
Special rules applicable to SME’s benefiting from the reduced CIT rate in accordance with art. 215 (2) ITC.		

Loss carry-back reserve

Example 1: Diamond Regime – taxable basis is **higher** than the 'minimum floor'

Assumptions	
Accounting profit before taxes	EUR 100
Turnover stemming from diamond trading	EUR 10,000
The "**minimum floor**" of **0.55%** on turnover applies	EUR 55
Total amount of (regular) disallowed expenses (e.g. non-deductible car expenses, restaurant expenses, etc.)	EUR 15
Purchase of diamonds	EUR 9,900

Corporate Income Tax	
Net accounting profit (incl. all professional expenses)	EUR 100
Comparison between the actual gross margin realized *vs.* the lump sum gross margin of 2.1% on turnover	EUR 100 [i.e. EUR 10,000 – EUR 9,900] *vs.* EUR 210 [i.e. 2.1% on a turnover of EUR 10,000]
Considering that the lump sum gross margin of 2.1% has not been reached, the company will have to record an additional disallowed expense in its corporate income tax return	+ EUR 110 [i.e. EUR 210 – EUR 100]
The previously calculated disallowed expenses	EUR 15
Taxable result under the Diamond Regime	**EUR 100 + EUR 110 + EUR 15 = EUR 225**

Loss carry-back reserve

Example 1: Diamond Regime – taxable basis is **higher** than the 'minimum floor' **with penalty**

COVID-19

31 Dec 2019

31 Dec 2020

In FY 2019

- Company X realizes a taxable result of **EUR 225 under the Diamond Regime** in tax year 2020 (financial year 2019);
- Company X **anticipates,** for tax year 2021 (financial year 2020), **accounting loss of EUR 200;**
- Company X decides to create **a tax exempt reserve of EUR 200**, so that tax base of tax year 2020 is reduced to **EUR 25**
- CIT due in tax year 2020: EUR 25 *29.58% = EUR 7.40;
- CIT due in tax year 2020 without carry back: EUR 225 *29.58% = EUR 66.56
- **Cash saving**: EUR 66.56 – EUR 7.40 = **EUR 59.16**

In FY 2020 (reserve recapture)

- At the end of tax year 2021 (financial year 2020), **accounting loss actually incurred is EUR 100;**
- Company X should include the amount of the tax exempt reserve (cf. in its taxable base of tax year 2020) with **18.32% increase**;
- Amount of the reserve recapture with increase: EUR 200 + 18.32%*200 = **EUR 236.64**;
- CIT due for tax year 2021: (EUR 236.64 – EUR 100)*25% = **EUR 34.16**

Penalty if loss is overestimated:

- **Penalty** in case >10% loss overestimation;
- **Loss overestimation**: EUR 236.64 – EUR 100 = **EUR 136.64** (i.e. >10%*100);
- **Amount of penalty** calculated through complex operations:
  - **Base** = 25%*(increased reverse recapture – loss of the year – 10% tolerance) => 25%*(236.64 – 100 – 10) = **EUR 31.66**
  - **Rate** (ranging between 2% and 40%) = 20%*(FY 2020 tax base / FY 2020 loss actually incurred) => 20%*(136.64 / 100) = **27.33%**
- **Penalty due**: EUR 31.66*27.33% = **EUR 8.65**

Loss carry-back reserve

Example 1: Diamond Regime – taxable basis is **higher** than the 'minimum floor' **without penalty**

COVID-19

31 Dec 2019

31 Dec 2020

In FY 2019

- Company X realizes a taxable result of **EUR 225 under the Diamond Regime** in tax year 2020 (financial year 2019);
- Company X **anticipates,** for tax year 2021 (financial year 2020), **accounting loss of EUR 200;**
- Company X decides to create **a tax exempt reserve of EUR 169.03**, so that tax base of tax year 2020 is reduced to **EUR 55.97**
- CIT due in tax year 2020: EUR 55.97 *29.58% = EUR 16.56;
- CIT due in tax year 2020 without carry back: EUR 225 *29.58% = EUR 66.56
- **Cash saving**: EUR 66.56 – EUR 16.56 = **EUR 50**

In FY 2020 (reserve recapture)

- At the end of tax year 2021 (financial year 2020) the **EUR 200 loss is confirmed**;
- Company X includes the amount of the tax exempt reserve (cf. in its taxable base of tax year 2020) (**recapture**);
- Amount of the **reserve recapture with increase**: EUR 169.03 + 18.32%*169.03 = **EUR 200**
- CIT due for tax year 2021: (EUR 200 – EUR 200)*25% = **EUR 0.**

Penalties if loss is overestimated:

- Penalty in case of >10% loss overestimation;
- In case at hand, **no overestimation** (loss carry-back reserve was discounted by the recapture increase of 18.32%, to equal the actual loss at the end of the FY 2020, i.e. EUR 200).

Loss carry-back reserve

Example 2: Diamond Regime – taxable basis remains **below** the 'minimum floor'

Assumptions	
Accounting profit before taxes	EUR 100
Turnover stemming from diamond trading	EUR 10,000
The "**minimum floor**" of **0.55%** on turnover applies	EUR 55
Total amount of (regular) disallowed expenses (e.g. non-deductible car expenses, restaurant expenses, etc.)	EUR 15
Purchase of diamonds	EUR 9,700
Corporate Income Tax	
Net accounting profit (incl. all professional expenses)	EUR 100
Comparison between the actual gross margin realized *vs.* the lump sum gross margin of 2.1% on turnover	EUR 300 [i.e. EUR 10,000 – EUR 9,700] *vs.* EUR 210 [i.e. 2.1% on a turnover of EUR 10,000]
The amount exceeding the lump sum gross margin of 2.1% on turnover can be deducted from an income tax perspective through an increase of the opening balance of the taxed reserves in the corporate income tax return	EUR -90 [i.e. EUR 210 – EUR 300]
The previously calculated disallowed expenses	EUR 15
Taxable result under the Diamond Regime **However: minimum floor of 0.55% on turnover amounting to EUR 10,000**	[EUR 100 - EUR 90 + EUR 15] = EUR 25 **EUR 55**

Loss carry-back reserve

Example 2: Diamond Regime – taxable basis remains **below** the 'minimum floor' <u>**with penalty**</u>

COVID-19

31 Dec 2019 — **31 Dec 2020**

In FY 2019

- Company X realizes a taxable result of **EUR 55 under the Diamond Regime** in tax year 2020 (financial year 2019);
- Company X **anticipates,** for tax year 2021 (financial year 2020), **accounting loss of EUR 40;**
- Company X decides to create **a tax exempt reserve of EUR 40**, so that tax base of tax year 2020 is reduced to **EUR 15**
- CIT due in tax year 2020: EUR 15 *29.58% = EUR 4.44;
- CIT due in tax year 2020 without carry back: EUR 55 *29.58% = EUR 16.27
- **Cash saving**: EUR 16.27 – EUR 4.44 = **EUR 11.83**

In FY 2020 (reserve recapture)

- At the end of tax year 2021 (financial year 2020), **accounting loss actually incurred is EUR 20;**
- Company X should include the amount of the tax exempt reserve in its taxable base of tax year 2020 with **18.32% increase**;
- Amount of the reserve recapture with increase: EUR 40 + 18.32%*40 = **EUR 47.33**;
- CIT due for tax year 2021: (EUR 47.33 – EUR 20)*25% = **EUR 6.83**

Penalty if loss is overestimated:

- **Penalty** in case >10% loss overestimation;
- **Loss overestimation**: EUR 47.33 – EUR 20 = **EUR 27.33** (i.e. >10%*20);
- **Amount of penalty** calculated through complex operations:
  - **Base** = 25%*(increased reverse recapture – loss of the year – 10% tolerance) => 25%*(47.33 – 20 – 2) = **EUR 6.33**
  - **Rate** (ranging between 2% and 40%) = 20%*(FY 2020 tax base / FY 2020 loss actually incurred) => 20%*(27.33 / 20) = **27.33%**
- **Penalty due**: EUR 6.33*27.33% = **EUR 1.73**

Loss carry-back reserve

Example 2: Diamond Regime – taxable basis remains **below** the ‘minimum floor’ **<u>without penalty</u>**

31 Dec 2019

COVID-19

31 Dec 2020

In FY 2019

- Company X realizes a taxable result of **EUR 55 under the Diamond Regime** in tax year 2020 (financial year 2019);
- Company X **anticipates,** for tax year 2021 (financial year 2020), **accounting loss of EUR 40;**
- Company X decides to create **a tax exempt reserve of EUR 33.81**, so that tax base of tax year 2020 is reduced to **EUR 21.19**
- CIT due in tax year 2020: EUR 21.19 *29.58% = EUR 6.27;
- CIT due in tax year 2020 without carry back: EUR 55 *29.58% = EUR 16.27
- **Cash saving**: EUR 16.27 – EUR 6.27 = **EUR 10**

In FY 2020 (reserve recapture)

- At the end of tax year 2021 (financial year 2020) the **EUR 40 accounting loss is confirmed**;
- Company X includes the amount of the tax exempt reserve in its taxable base of tax year 2020 (**recapture**);
- Amount of the **reserve recapture with increase**: EUR 33.81 + 18.32%*33.81 = **EUR 40**
- CIT due for tax year 2021: (EUR 40 – EUR 40)*25% = **EUR 0.**

Penalties if loss is overestimated:

- Penalty in case of >10% loss overestimation;
- In case at hand, **no overestimation** (loss carry back reserve was discounted by the recapture increase of 18.32%, to equal the actual loss at the end of the FY 2020, i.e. EUR 40).

Loss carry-back reserve

Impact of equity distributions

Which transactions ?

- **Dividends** (including a distribution of "liquidation reserves");
- **Buyback** of **own shares;**
- **Capital reduction** (including a capital reduction meant by art. 537 ITC : reserves included in the capital);
- Any **other reduction or distribution of equity** (e.g. distribution of issue premium).

Carried out when ?

- **From 12 March 2020 up to and including the filing of the tax year 2021 tax return.**

Alternatives ?

- Intercompany loans (beware of parent company taxation implications, e.g. deemed dividend);
- Postponement or "wait and see" (e.g. intermediary dividend in the second half of the year if and when clear whether loss carry-back could apply / actual loss is expected);
- Other COVID-19 measures.

Loss carry-back reserve

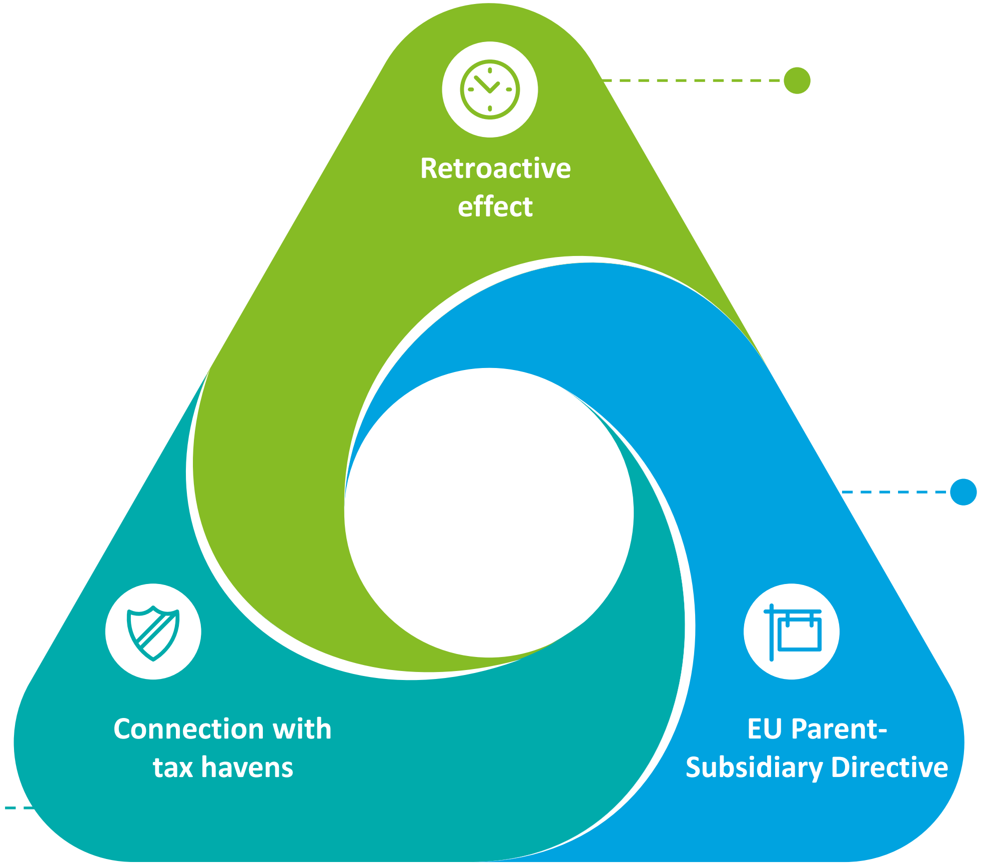
Potential concerns

The benefit is <u>not</u> available to companies that:

- **hold direct shareholding** in a company established in a tax haven or
- **make payments** of at least **EUR 100,000** towards beneficiaries located in tax havens.

As mentioned above, in respect to the second criterion, counterproof is effectively possible based on a so-called “business purpose”-test.

Such counterproof is not available for the first criterion. The Council of State, referring to CJEU jurisprudence, states that the proportionality principle is not respected and the automatic exclusion should be reconsidered.

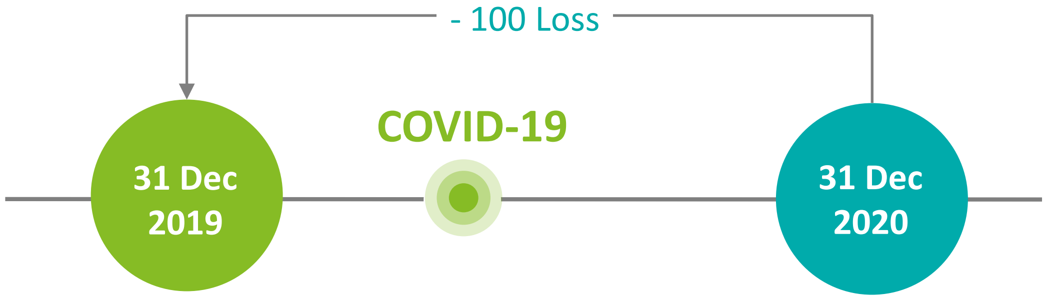


- Companies having performed equity distributions (cf. above) as from 12 March 2020 are excluded from this benefit, despite the measure was only announced on 15 May 2020.

- (Maximum) carry back is limited cf. supra.
- Excess DRD, despite being “equivalent” to tax losses, does not qualify for carry back. As such, companies with (tax exempt) dividend income may be discriminated and the measure may be in breach of the EU Parent-Subsidiary Directive (CJEU C-389/18 of 19 December 2019 re. Brussels Securities SA).

Loss carry-back reserve

Interactions



Intra-group transfer of losses

- Loss carry-back and **group contribution regime** to be managed carefully (*cumul* not applicable for taxpayers subject to the Diamond Regime).

Interest limitation rule

- Deduction of net borrowing costs limited to the higher of EUR 3mio and **30% of adjusted EBITDA**.
- Impact of the loss carry-back: does the tax exempt reserve reduce the amount of available adjusted EBITDA, hence, restricting the deduction of net borrowing costs ?
- In this regard, the Belgian minister of finance stated - during the parliamentary discussion on the text of Corona II law - that "*the ATAD directive is very clear that **exempt income should not be taken into account for the calculation of the EBITDA**. Since the COVID-19 reserve is tax exempt, this reserve should not be included in calculation of the EBITDA for the purpose of the interest deduction restriction*".
- Further ministerial or administrative clarification should be provided.

Recovery reserve

Recovery reserve

Law proposal

Law proposal

- Initial proposal on the recovery reserve in the (draft) Corona II law was rejected as well as the amendment to the (draft) Corona III Law containing a provision on the recovery reserve.
- Council of State: why would companies subject to the Diamond Regime not be excluded ? Minister of finance: this is due to the fact that the Diamond Regime is not a deviating nor beneficial tax regime.

Re-introduced as a separate law (companies subject to the Diamond Regime are indeed not excluded)

What ?

- Companies recording accounting losses for financial year 2020 or 2021 could create **a tax-exempt recovery reserve** to offset the profits of tax year 2022, 2023 or 2024.
- **Recapture** if a company distributes equity or significantly reduces its personnel cost.

Purpose ?

The reserve allows companies to maintain future profits by exempting the profits from tax in order to **restore the pre-COVID-19 equity**.

Recovery reserve

Conditions, exclusions and anti-abuse provisions

Maximum recovery reserve

The exemption would be limited to a maximum amount (which includes the already taxed recaptured amounts, cf. infra) which is equal to the amount of the **accounting losses** recorded in the company's financial statements, depending on the company's closing date as specified below:

- Companies closing their financial year between 1 January 2020 and 31 July 2020 can choose for the accounting losses recorded in the financial statements closing in 2021 (irrevocable choice to be made at the time of the initial set-up of the reserve);
- Companies closing their financial year between 1 August 2020 and 31 December 2020 should consider the accounting losses recorded in the financial statements closing in 2020;
- the reserve will in any event be capped at a maximum amount of EUR 20,000,000.

Conditions

- This reserve would be subject to the **intangibility condition** and would have to be recorded on a separate tax-free reserve account.
- Hence, the reserve would **ultimately** become **taxable upon liquidation**.

Exclusions

- Companies with **a special tax regime**: investment companies, pension financing organizations, cooperative holding companies, companies subject to "tonnage tax".
- Companies **in distress on 18 March 2020**.
- Companies that have made a dividend distribution, share buyback, capital reduction or other equity distribution **(as of 12 March 2020 up to and including the date of filing of the tax return for the year of constitution of the recovery reserve)** – cf. loss carry-back reserve.
- Companies that have **a substantial link with tax havens**:
  - Hold direct shareholding in a company established in a tax haven;
  - Make payments (>EUR 100,000) to companies established in a tax haven, unless it has been demonstrated that these payments were made in context of real and sincere operations resulting from legitimate financial or economic needs.

Recovery reserve

Recapture

Recapture of tax exempt reserve

- The recovery reserve would have to be **recaptured** and would become (partially) taxable for the taxable period during which the company either:
    i. executes a prohibited equity distribution; *or*
    ii. reduces significantly its personnel cost.
- A **prohibited equity distribution** in this case is:
    - A buy-back of own shares;
    - An attribution or distribution of dividends;
    - A capital decrease or any other reduction or distribution of equity.

    ⇒ The taxable amount of the recapture would be equal to the value of the share buyback, the amount of the dividend or the amount of the capital decrease or any other equity reduction or distribution.
- A **significant personnel cost reduction** would exist when:
    - the amount recorded in column 620 of the profit and loss account, “Remunerations and direct social benefits”, is lower than 85% of the amount recorded in the same column at the closing of the financial year in 2019, if this condition is met (i.e. if this significant personnel cost reduction occurs for the first time) during the taxable period concerned; *or*
    - the company records an amount in the column 620 of the profit and loss account that is below the previous “floor”, if this condition is met in a previous taxable period.

    ⇒ The taxable amount of the recapture would be equal to the difference between (i) the floor of 85% or the previous floor, and (ii) the above-mentioned amount in the column 620 “Remunerations and other direct social benefits” recorded for the taxable period concerned which is below either the floor of 85% or the previous floor

Recovery reserve

Example

	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023
Result of the year	100	(70)	30	60	70
Allocation to recovery reserve	N/A	N/A	30	40	0
Recovery reserve (cumulated)	0	0	30	70**	70
Tax base	100*	0	0	20	70
CIT due	29.58	0	0	5	17.5
Cash saving	**N/A**	**N/A**	**7.5**	**10**	**0**

* no loss carry back applied

** recovery reserve cannot exceed the lower amount of the accounting losses at the end of FY 2020 or EUR 20 mio

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