Belgium: Determination of the seat of effective management

I. Introduction

The decision of the Court of Appeal of Ghent dated 29 March 2022 (n°2021/AR/46) concerns the interpretation and application of the residence tie-breaker rule of Article 4 (in this case, §3) of the Belgian-Hong Kong DTC of 10 December 2003 (called "Agreement between the Kingdom of Belgium and the Hong Kong Special Administrative Region of the People's Republic of China").

As a quick reminder, the tie-breaker rule is a treaty provision that is used in case a taxpayer – individual or legal person – is considered a resident by both contracting states (so-called dual residence[1] situation).

In this regard and considering the aims, the structure (distributive rules), and the application of an international tax treaty (DTC), it is essential that a person is regarded as a resident of only one contracting state in order to avoid double taxation issues (as a rule, if one of the contracting states is regarded as the state of residence, the other contracting state, in principle, loses its taxing power)[2].

Conversely, from the taxpayer's point of view, it can be of great interest and advantage to be regarded as a resident of the contracting state in which the tax

[1] According to K. van RAAD, a "dual residence" "results from the treatment by each of two States of a particular taxpayer as a person subject to full tax liability (e.g., tax liability in respect of worldwide income, capital, etc.) because of his residence within their respective territories or of any other jurisdictional criterion.*"* See : K. van RAAD, "Dual residence", in *European Taxation*, August 1988, p. 241.

[2] E. KEMMEREN, "Netherlands: Place where a company is managed and controlled in order to determine the tax treaty residence", in Tax Treaty Case Law around the Globe 2019, IBFD, Linde, pp.60-61.

burdens are low(er). To achieve that goal, some company structures that have or do not have an operative activity may be incorporated.

In the case at hand, the person in question (e.g. the taxpayer and appellant) is a company that has its main office in Belgium and also operates from China and Hong Kong. This raises the question of where its "seat of effective management" is located and therefore the issue of the allocation of the taxing powers in such a case. In several European countries (e.g. Belgium, Germany, Italy, or the Netherlands), the "place of effective management" is used as a (the) test of corporate residence. Common law countries have developed a similar but differently interpreted test of corporate residence of central management and control of "*where the central management and control actually abides*".[3] Its interpretation depends mainly, even exclusively, on the (factual) criteria used by the domestic jurisdictions. Although criteria and guidance are given by the OECD Commentary in this regard, jurisdictions may depart from these criteria and apply other ones.

II. Facts of the case

Nicol and Danny B are both shareholders of the Belgian company "Mannequins B" that is specialized in manufacturing mannequins for displays.

They are also shareholders of the manufacturing company of Chinese law "G Ltd." established in China (Guangzhou) in 1994 as well as a company established in 2010 in Hong Kong (the taxpayer and appellant). The latter served as an intermediary between "G Ltd." and "Mannequins B".

[3] For an overview of the situation in the various European states as well as critical reflection of the concept of corporate tax residence, see E. TRAVERSA (ed.), Corporate Tax Residence and Mobility, EATLP International Tax Series, vol. 16, IBFD, 2018. See also J. AVERY JONES & Co., "The origins of concepts and expressions used in the OECD Model and their adoption by States", in *Bulletin*, June 2006, p.232.

The case is a consequence of a criminal investigation against a certified accountant and tax adviser specialized in advising international tax structures.

In this context, the Belgian tax administration sent a registered letter dated 22 September 2016 to the appellant in Aalter (Belgium) which is the address of the registered office of the Belgian company "Mannequins B". It was a notification of *ex officio* taxation for the year 2014. The appellant did not react to this notification. According to the Belgian tax administration, a request for information was also sent to the company incorporated in Hong Kong.

By registered letter dated 3 November 2016, the Belgian tax administration sent a notification for the extension of the investigation period (according to Article 333 of the Belgian Income Tax Code) on behalf of the appellant to the company's address in Belgium with a copy to the appellant's address in Hong Kong.

In said notification, the Belgian tax administration indicated that it considered the appellant's tax domicile to be at the address in Aalter (Belgium) and not in Hong Kong. In other words, the administration considered the company only established *pro forma* in Hong Kong. As a consequence, as a mere "letter-box company", the "seat of effective management" of the company was Belgium.

III. The Court Decision

This position of the Belgian tax administration was confirmed by the Court of Appeal of Ghent which based its decision on the following criteria: (i) the shareholders and beneficiaries are Belgian; (ii) the use of local "nominees" whose role was to appear as administrators but solely to execute the decisions taken by "B"; (iii) the circumstance that no real activity was carried out in Hong Kong; (iv) the fact that all goods were re-invoiced by the Hong Kong company and shipped between the Chinese and the Belgian companies; (v) the fact that the company had no permanent premises or infrastructure in Hong Kong between November 2010 and March 2015; (vi) the fact that the seat of the company was located at the office of the company's auditors with no permanent access to these premises; and (vii) the circumstance that the payments were made from Belgium and concerned sales between "B" and Chinese companies and wages of employees in China.

Based on the criteria mentioned above, the Court of Appeal of Ghent concluded that "the appellant attempted, without any added value, to subject a relatively large gross profit margin to the favourable tax regime in Hong Kong, while being managed entirely from Belgium."

IV. Comments on the Court's Reasoning

Facing the legal issue of a company dual residence between Belgium and Hong Kong, the Court of Appeal of Ghent based its legal reasoning on the tie-breaker rule embodied in Article 4, §3 of the Belgium-Hong Kong DTC.

However, before entering into this main issue, the court did not examine the issue of whether or not the company could effectively be regarded as a resident of both contracting states according to the respective domestic legislation. The Court of Appeal of Ghent assumed that this was the case.

According to Article 4, §3 of the Belgium-Hong Kong DTC, a company shall be deemed to be a resident of the contracting state in which the company's "seat of effective management" is located. Although the fact that the expression "seat of effective management" is not defined, the Court of Appeal of Ghent did not undertake a proper interpretation work: It did not refer to the general interpretation rules (i.e. Articles 31-33) of the Vienna Convention on the Law of Treaties nor to the OECD Commentary.

Furthermore, the Court of Appeal of Ghent did not, in any way, take into consideration the Hong Kong point of view when interpreting the expression "seat of effective management".

According to the Court of Appeal of Ghent, the expression "seat of effective management" must be understood as the place where the fundamental decisions are taken, the place from which the company is effectively managed, and where initiatives are taken.

In fact, the Court of Appeal of Ghent did not focus its reasoning and decision on the interpretation and application of tax treaty sources or principles but merely on Belgian internal tax law. It referred to Article 2, §1, 5°, b) of the Belgian Income Tax Code that a "resident company" as a company having its main establishment or its main seat of direction or management in Belgium that is not excluded from the scope of corporate tax.

Regarding the determination of the taxpayer's seat of effective management, it is interesting to note that, also in this regard, the Court of Appeal of Ghent did not refer to the criteria listed in the OECD Commentary[4] such as, for example: (i) the place of meeting of the board of directors; (ii) the place where the CEO (or other senior executives) usually carry on their activities; (iii) the location of the person's headquarters; and (iv) the place where the accounting records are kept.

In fact, to be more precise, the Court of Appeal of Ghent did not refer to any OECD Commentary nor OECD source; this can be seen as an omission in the court's interpretation work.

The criteria listed by the OECD Commentary mentioned above evidence that the expression "seat of effective management" should be interpreted as the place where the key *operative* decisions[5] in respect of the taxpayer's activities are made (based on the accounting books) and from where instructions are given to persons active within the company. From a tax treaty historical perspective as well as according to Belgian law, said expression also refers to the place where the shareholders meet[6].

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[4] OECD Commentary of August 2019 to Article 4, par. 24-1.
[5] Court of Appeal of Liège, decision of 23 April 2021 (2018/RG/1133), www.fisconetplus.be

- As already mentioned, the criteria used by the Court of Appeal of Ghent (see above III. The Court Decision) are not similar to those that are listed in the OECD Commentary. According to the authors' opinion, the criteria taken into consideration by the Court of Appeal of Ghent are more relevant and appropriate for establishing that the taxpayer must be seen as a "letterbox company" (e.g. an empty shell without real activity and therefore without substance) than to determine where the company's seat of effective management is located.

The circumstance that the company established in Hong Kong must be seen as a "letterbox company" does not indeed automatically imply that the company is effectively managed from Belgium. In this regard, the authors share the opinion of Kemmeren according to which, in some cases, "the problem of the dual resident will not always be solved".[7]

It is interesting to compare with some other case law. So, according to the decision of the Court of Appeal of Liège dated 23 April 2021[8], a company's seat of effective management is located at the place where the key managerial and business decisions are made that are necessary for the conduct of business activities and are made from the territory of that state.

In that case, the Court of Appeal of Liège based its decision on the following factual elements: (i) the fact that an employee of the Luxemburg company took a day off to assist the bookkeeping staff in Belgium; (ii) the fact that the planning of the week regarding tractors of both the Belgian and Luxemburg company was kept in premises located in Belgium; and (iii) the fact that the

[6] J. AVERY JONES & Co., "The origins of concepts and expressions used in the OECD Model and their adoption by States", in *Bulletin*, June 2006, p.233, n°2.8.3.; Commentary to the Belgian Income Tax Code, n°179/23.

[7] E. KEMMEREN, "Netherlands: Place where a company is managed and controlled in order to determine the tax treaty residence", in Tax Treaty Case Law around the Globe 2019, IBFD, Linde, p.73.

[8] See also Court of Appeal of Liège, decision of 17th June 2022 (RG.: 2020/RG/751), www.fisconetplus.be.

archives of the Luxemburg company (e.g. invoices, extracts of bank accounts, CMR transport documentation, etc. for the period between 2010 and 2013) were kept in a warehouse located in Belgium. Although this third criterion might be regarded as rather insufficient, it is, however, in line with the Belgian tax administration's view[9].

Conversely, according to the Court of Appeal of Liège, the circumstances that a company has its head office, bank accounts, pays taxes. and holds even minor investments on the territory of the other contracting state (in the case at hand, in Luxemburg) does not imply that the company's seat of effective management is located in that country[10].

From the above considerations and elements, it can be concluded that the Court of Appeal of Liège took a "pragmatic", factual, and non-formalistic based approach to determine a company's seat of effective management even if the criteria used seem rather inadequate or insufficient to determine the place where the company's key operative decisions are made.

Such an approach was also followed by the Court of Appeal of Ghent in its decision.

V. Conclusion

According to the authors' opinion, the decision of the Court of Appeal of Ghent may be approved on the merits but tends to mix domestic and international rules

[9] Commentary to the Belgian Income Tax Code, n°179/23.

[10] Interestingly, in a later decision dated 10 January 2022 (RG. : 2019/RG/635), the Court of Appeal of Liège ruled that the criteria establishing the location of a company's head office (place where the premises, warehouses, trucks, transportation license, etc. are located) could also be used to establish the location of the company's seat of effective management.

of residence. It could have been better motivated to reflect more precisely the structure and wording of the applicable treaty:

- The Court of Appeal of Ghent seems to assume, without examining that issue, that the taxpayer could be regarded as a resident of both contracting states according to their respective legislation.

- It based its entire reasoning on that issue by merely quoting Article 4, §3 of the Belgium-Hong Kong DTC but without trying to interpret the expression "seat of effective management" in light of OECD sources such as, in particular, the OECD Commentary. It neither referred to the general interpretation rules or principles of the Vienna Convention on the Law of Treaties (e.g. Articles 31-33) nor took into consideration the Hong Kong point of view interpreting the expression "seat of effective management".

Regarding the criteria used by the Court of Appeal of Ghent to determine the location of the company's seat of effective management, it is interesting to notice that these criteria have led to the conclusion that the Hong Kong company must be regarded as an empty shell (e.g. a so-called "letterbox" company). However, many of the elements put forward by the court do not necessarily lead to the conclusion that the company was effectively managed from Belgium. Only the fact that payments were made from Belgium and, to a lesser extent, that the shareholders were Belgian residents could give an indication that the company was actually a Belgian resident. It is moreover unclear whether those factual elements aim at supporting the taxpayer's residence in Belgium under domestic law or under the treaty.

Therefore, the conclusion that the company's seat of effective management is located in Belgium seems, in fact, to be based on an *a contrario* reasoning for determining a single place of residence.