Transfer Pricing Forum

Transfer Pricing for the International Practitioner

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France

Julien Monsenego *and* Céline Viault

Delsol Avocats

Legislation

In France, there have not been any new regulations relating to transfer pricing *per se* through 2020. However, some new legislation that has indirect impact on transfer pricing came into force on January 1, 2020.

Transposition of ATAD II

As a result of the transposition into French law of the Anti-Tax Avoidance Directive II ("ATAD II"), the French mechanism providing for a non-deduction of interest in the event of low taxation or the exemption of the corresponding interest income in the related lender company (under Article 212, I-b of the French Tax Code) was eliminated.

The new "anti-hybrid/subject-to-tax" rules (set out in Articles 205 B, 205 C, and 205 D of the French Tax Code) address the following types of arrangements: situations that give rise to a deduction without inclusion of a payment, situations that give rise to a double deduction, and other specific situations such as a reverse hybrid. This new legislation applies not only to interest but also to any other types of payments. However, ATAD II applies only if there is a difference in the character of payments between the two States concerned by the payment, a condition which was not required for the application of Article 212, I-b of the French Tax Code.

Section of the French Tax Code that Deals with Transactions with Entities Located in Tax Havens

Article 238 A of the French Tax Code limits the deductibility in France of commissions and other payments made to entities located in privileged tax regimes.[1] A company is deemed to benefit from a privileged tax regime when the difference between the foreign corporate tax and the tax that would have been paid in France exceeds 40% (there was a reduction of the threshold from 50% to 40%).

DAC6 (Transfer Pricing Hallmarks)

France approved the six-month extension for reporting cross-border arrangements under the Directive on Administrative Cooperation 6 ("DAC6"), which was provided by Council Directive (EU) 2020/876. The deadline to report the qualified arrangements, which was originally set out between June 25, 2018 and June 30, 2020, was deferred to February 28, 2021. Likewise, the 30-day deadline to report qualified arrangements for the period between July 1 and December 31, 2020 was deferred to January 1, 2021. In addition, the new

[1] If the beneficiary is subject to a privileged tax regime, the deduction is possible only under the condition that the payer of these expenses proves that they relate to real transactions and are not excessive or unusual.

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reporting deadline for quarterly reporting on marketable arrangements is April 30, 2021.

It should be noted that, ordinance No. 2019-1068 of October 21, 2019, provides for a mandatory automatic exchange of tax information in relation to reportable cross-border arrangements.

Furthermore, on March 19, 2020, the French government published Decree No. 2020-270 which regulates the content requirements included in the declaration of a cross-border arrangement provided in Article 1649 AD of the French Tax Code. The French Tax Authority has also published some additional guidelines on this reporting obligation (BOI-CF-CPF-30-40).

Interest Rate Between Related Parties on Financing Operations

In January 2021, the French Tax Authority published 8 on-line practical guides on the various possible options for companies to prove a market interest rate applied to financial transactions between related parties, including, in particular, information about evidence requirements, credit rating and the use of the bond financial market as a possible benchmark.[2]

Cases and Rulings

Case Law Regarding Interest Rate Between Related Parties

The deduction of interest paid to an affiliated company is limited to the interest determined in application of the rate mentioned in Article 39, 1-3° of the FTC (i.e., annual average effective rates charged by credit institutions for variable-rate loans with a term of more than 2 years - the "Maximum tax-deductible Rate"), unless the borrowing company can demonstrate that the interest rate applied corresponds to a market rate (i.e., an interest rate that the company could have obtained from an independent lender under the same conditions).

In December 2020, the French Supreme Court (Conseil d'Etat, "CE") issued two important decisions regarding the evidence enabling a company to support the interest rate charged on loans granted by a related company.

In the *Société WB Ambassador* case (CE, December 10, 2020, No. 428522), the French Supreme Court considered that the intragroup interest rate relevance can be demonstrated by any means. Therefore, the CE accepted bond market references (external benchmarks) to justify intragroup arm's length interest rates. Accordingly, the borrowing entity may take account of the yield on bond loans from companies in comparable economic conditions when such loans constitute a realistic alternative to an intragroup loan.[3]

In the SA BSA case (CE, December 11, 2020, No. 433723), the French Supreme Court overruled the Administrative Court of Appeal's ruling which had rejected the evidence produced by a taxpayer to demonstrate that the interest rates applied to the intragroup loans were in line with the market rate. The

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[2] https://www.impots.gouv.fr/portail/files/media/1_metier/2_professionnel/EV/2_gestion/210_declarer_payer/taux_dinteret_des_emprunts_aupres_dentreprises_liees_-_8_fiches_pratiques.pdf.
[3] The Court does not provide any details on the notions of "comparable economic conditions" or a "realistic alternative to an intra-group loan." This should be examined on a case-by-case basis.

judges consider that the studies and means of evidence provided by taxpayers cannot be challenged without a serious justification.[4]

Other Important Decisions

Furthermore, the French Supreme Court issued other important transfer pricing related decisions, in particular:

- The *Société Ferragamo France* case (CE, November 23, 2020, No. 425577) involved the French distribution affiliate of Salvatore Ferragamo SPA, a luxury shoe manufacturer. The French Supreme Court pointed out the fact that the French distribution affiliate incurred significant operating expenses (i.e. qualified staff, flagship shop location); that the company had recurring loss positions and that the expenses incurred by the French affiliate were higher than the ones incurred by other distributors in a comparable situation.

  Thus, the judges considered that the remuneration paid by the Italian company to its French branch did not allow the latter to cover these expenses and that the exposure of such expenses aimed at increasing the value of the Italian brand. The transaction was deemed as an indirect transfer of profits from the branch to the Italian company. This decision seems to question the principle of non-interference of the French Tax Authority over the corporate management of a French taxpayer and, in particular, the ability to make certain decisions regarding the management of the launching phase of an international group on the French market.

- In the *Piaggio* case (CE, October 4, 2019, No. 418817), following a restructuring of the Italian Piaggio group, SAS Piaggio France was changed from an exclusive distributor of vehicles of the "Piaggio" brand in France to a commercial agent for its Italian parent company.

  The judges considered that in these circumstances, the transformation of an exclusive distributor into a commercial agent may result in a transfer of clientele. Indeed, the French Supreme Court confirmed the analysis of the French Tax Authority according to which the change in the contractual relations between the parties has resulted in a transfer of customers for which a selling independent party would have been remunerated. Thus, the transfer of customers without payment, resulted in an indirect transfer of profits and is therefore, subject to a tax reassessment based on the provisions of Article 57 of the French Tax Code.

- Regarding permanent establishment issues that have indirect impact on transfer pricing, the *Conversant International Ltd* case (CE, December 11, 2020, No. 420174) involved an Irish company operating in the digital sector and benefiting from marketing and promotional services rendered by another company of the group established in France. The French Supreme Court ruled that the French company can qualify as a dependent agent (and thus, as a French permanent establishment) of the Irish company if the French company habitually exercises the authority to conclude contracts in the name of the Irish affiliate, even though formal consent to these contracts is only given by the Irish company.[5]

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[4] The French Supreme Court annulled the Court of Appeal's judgment because it determined that the Court of Appeal had rejected the supporting documents submitted to it without providing sufficient justification for said rejection. With this decision, the French Supreme Court reminds lower courts that when they reject supporting documents presented to them, they must substantiate their rejections.
[5] The Supreme Court explicitly grounded its decision on the OECD comments on the tax treaty concluded between Ireland and France (comments published in 2003 and 2005).

This decision raises the question of the portion of the profit that should be allocated to the permanent establishment. The French Tax Authorities considered that the turnover of the permanent establishment should be calculated on the basis of all the amounts received in the bank accounts of the Irish company in France and evaluated the expenses at 80% of this turnover (20% margin). This case was appealed by the taxpayer and will be considered by the Court of Appeal.

Finally, in this case, the French Tax Authority could choose between two possible tax reassessments, either a transfer pricing reassessment, by increasing the remuneration of the French company, or by considering the creation of a permanent establishment in France of a foreign entity. It should be noted that the consequences of each of these two case-scenarios are different. The latter generally leads the French Tax Authority to qualify the situation as a hidden activity, in which case the statute of limitation period is longer and an automatic 80% penalty is applied, usually resulting in the referral of the case to the Public Prosecutor, since the entry into force of the law of October 23, 2018 relating to the fight against fraud.

This case demonstrates the importance of paying attention to the allocated functions and conditions in the intervention of French subsidiaries and their personnel in Digital/E-commerce foreign principals/entrepreneurs.

Transfer Pricing Documentation

For several years now, French law requires three main types of transfer pricing documentation and reporting requirements:

- Master file and Local file documentation;
- Annual transfer pricing declaration on Form 2257-SD,6 also known as the "abridged transfer pricing documentation"; and
- Country-by-country (CbC) reporting.

In 2020, the tax authorities granted a deferral to submit the annual transfer pricing declaration. Given the extended deadline for filing the corporate income tax return, the Form 2257-SD, which is typically due six months after the filing deadline for the corporate income tax return, was postponed to December 31, 2020 for companies with financial year ended on December 31, 2019.

[6] This form (separate from the CIT return) must be filed by the following companies:
- Entities with total net sales (before taxes) or total gross assets > €50 million;
- Entities holding, directly or indirectly, at the closing date of the fiscal year, more than 50% of the capital or voting rights in a legal person having such turnover or gross assets;
- Entities, on the closing date of the fiscal year, which are more than 50% held, directly or indirectly, by such legal person;
- Entities belonging to a French tax consolidated group that includes at least a legal person that meets one or more of the aforementioned criteria. In such a case, the declaration must be filed by the parent company.

Transfer Pricing Examinations/Audits

Transfer pricing issues are more than ever at the centre of tax inspectors concerns in the event of a tax audit. There has been an increase in the number of tax audits in this respect, often resulting in significant reassessments.

The following non-exhaustive list shows the main areas where the tax inspectors usually focus when reassessing transfer pricing positions adopted by taxpayers:

- The ability of the companies to provide the required transfer pricing documentation (Master File and Local File) on demand;
- Companies in a situation of persistent tax losses;
- The comparable studies supporting the transfer pricing methodology (difference in the appreciation of the concept of comparability);
- The remuneration of distributors, intragroup financing and royalties; and
- Cross-border relocations of assets or functions.

In addition, the EU Council Directive 2011/16 in relation to cross-border tax arrangements, known as DAC6, allows European tax administrations to conduct joint tax audits. There have not been many cases of this type of international cooperation until recently.

Impact of COVID-19

The OECD issued some guidance on the transfer pricing implications of the COVID-19 pandemic (published in English on December 18, 2020 and in French on January 20, 2021). This guidance clarifies and illustrates the practical application of the arm's length principle as articulated in the *OECD Transfer Pricing Guidelines* to the unique fact patterns and specific challenges implied by the COVID-19 pandemic. It was developed and approved by the 137 members of the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (including France).

The guidance provides clarification and support for taxpayers and for tax authorities as they evaluate and administer the application of transfer pricing rules for periods impacted by the COVID-19 pandemic, an area where international co-ordination is necessary.

Four priority issues were identified and are covered in the guidance:

- comparability analysis;
- losses and the allocation of COVID-19 specific costs;
- government assistance programmes; and
- advance pricing agreements ("APAs").

The French Tax Authority should follow this guidance, as it is generally the case with the OECD regulations. Generally, taxpayers should prepare full documentation to support the transfer pricing method applied during this particular period.

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What Can We Expect in 2021?

Transfer pricing should remain one of the main focusses of the French Tax Authority (especially in the context of the COVID-19 pandemic).

We can expect a willingness of companies to seek ways of supporting their transfer pricing policy thanks to:

- A special attention of the companies to the consistency of the transfer pricing documentation (between the Master file, Local file, Country-by-Country Reporting, and annual transfer pricing return with the Form 2257-SD);
- A renewed interest in APAs, in order to demonstrate the cooperation and transparency with the Tax Authority;
- Possible "*ex post*" reassessments for certain transactions (notably asset reallocations) that have occurred during COVID times and which may be considered as under-valued; and
- A further development of the relationship of trust with the Tax Authority thanks to the new trust-based relationship between companies and the French Tax Authority and, in particular, the partnership between the tax authorities and mid-cap/ large-cap companies and its international equivalent (International Compliance Assurance Programme 2, "ICAP 2"). However, companies will have to be cautious before initiating the trust-based relationship with the French Tax Authority because tax authorities, in practice, tend to investigate thoroughly the tax compliance of these companies by performing tax audits.

Julien Monsenego is a Partner – Co-Head of Tax Law at Delsol Avocats, and Céline Viault is a Tax Associate at Delsol Avocats. They may be contacted at:
jmonsenego@delsolavocats.com
cviault@delsolavocats.com
www.delsolavocats.com

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