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Transfer Pricing Forum

Transfer Pricing for the International Practitioner

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France

Julien Monsenego, Margot Lasserre, *and* Guillaume Madelpuech
Delsol Avocats; NERA Economic Consulting

1. Please describe your jurisdiction's (i) preliminary discussions or consultations; (ii) proposed measures; and/or (iii) enacted legislation associated with the taxation of digital activities. The discussion should include income tax and/or value added tax measures. Is there an estimation of the tax revenues that would be collected as a result of the enactment of these measures?

After the EU State Members failed to reach a consensus on a European common tax on digital services ("DST"), and similarly there being no consensus reached yet at the OECD level, the French Finance Minister committed to introduce such a tax at the national level.

The text was finally adopted by the French Parliament on July 11, 2019; and published on July 25, 2019. It will apply with retroactive effect from January 1, 2019.

According to the impact assessment, the French DST is of a temporary nature and is to be cancelled as soon as new international principles are adopted. However, this is not a binding commitment, but merely a political stance at this stage, as there is no provision for the automatic cancellation of the French DST upon the reaching of an agreement on the EU directive or the OECD guidance.

The French Parliament has however adopted an amendment according to which the French Government shall submit to Parliament, before September 30th of each year, a report on the negotiations conducted within the OECD and the EU. The report should emphasize the impact of the negotiations on the French DST, and indicate the potential date on which a new international mechanism could replace it.

This amendment was designed to recall the temporary nature of the DST, while taking into account the difficulties under French law to make the withdrawal of the DST conditional upon the adoption of an international text that is not yet adopted.

The DST is a 3% tax designed to apply to companies meeting the following three criteria: (i) they must provide specific digital services, (ii) in France, (iii) generating a certain amount of turnover.

(i) Material criterion (digital services under the scope)

Falling within the DST scope are the following services:

- Digital intermediation services, i.e. the provision of a digital interface to enable users of platforms to interact with each other in order to exchange goods or services (including marketplaces). An amendment adopted recently by the second legislative chamber has specified that the tax focuses on digital platforms and market places remunerated by a commission fee in exchange for the interaction enabled between users.
- Services aimed at placing targeted advertisements on a digital interface. The impact assessment emphasizes the importance of the "targeted" dimension of the advertising: "*those services must allow advertisers to place an ad on a website, depending on the individual data of the user consulting the said website*".
- The resale and management of personal data for advertising purposes.

In contrast, some services are expressly excluded from the DST scope, i.e., the provision of content on a platform, communication and payment services, as well as some regulated financial services and services provided between companies of the same taxpayer group.

We are expecting more details on these exclusions, and how to separate for example, marketplace activities within the DST scope and direct sales from a website, which should be excluded from the DST scope. This could be provided in the law or in administrative tax guidelines to be published later this year.

(ii) Territorial criterion (provision of services in France)

The criterion to determine whether a digital service is provided in France is not linked to the location of the company providing the services, as the DST precisely aims at taxing profits that are not covered by existing tax rules. The DST territorial criterion rather depends on the type of service provided:

- An intermediation service is considered to be provided in France when one of the users of the platform is located in France or has an account opened from France;
- A targeted advertising service is deemed to be located in France if the website displaying the targeted ad is consulted from France;

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- The sale of user data is considered to occur in France if the data is collected from a user located in France.

The way the user data will be tracked and disclosed for DST purposes is also a key aspect which requires clarification at this stage.

(iii) Quantitative criterion (turnover thresholds)

Two thresholds have to be reached for the DST to apply. Companies must have a "digital turnover" (i.e. a turnover generated by services falling under the scope of the DST) exceeding:

- EUR 750M worldwide, at consolidated group level, and
- EUR 25M in France.

According to the French government, the said tax should generate approximately 400 million euros of income for the French State per year.

2. What challenges has your jurisdiction faced in the (i) development; (ii) implementation; and/or (iii) tax audit of measures related to the taxation of the digitalized economy? What has been the reaction of multinational enterprises (MNEs) to any of these unilateral measures?

As in many other countries, traditional vehicles used by the French Tax Authorities – such as the permanent establishment ("PE") concept - appear to be unfit to tax the profits arising from the digital economy.

This was recently evidenced by a decision rendered by the Paris Administrative Court of Appeal (*CAA Paris, 25 April 2019, Google Ireland, n°17PA03065 to 3069*), in which the Court confirmed that Google Ireland had no PE in France as a result of activities performed by Google France, in particular because Google France was not able to contract in the name of Google Ireland. Therefore, Google Ireland was not liable for various French corporate taxes levied for the period from 2005 to 2010.

However, this decision was rendered under the previous PE definition, which has since evolved under the influence of the BEPS project. In adopting the OECD multilateral instrument (MLI), France adopted the broadest definition of the PE concept, notably, an extension of the dependent agent definition. France will now characterize a PE not only in case of conclusion of contract in the name of a foreign enterprise, but also "*when a person habitually [. . .] plays the principal role leading to the conclusion of contracts*", which implies that it is no longer necessary for the dependent agent to conclude the contract to characterize a PE.

Alongside this OECD initiative, and after the failure of the EU project to introduce a digital tax, the French Finance Minister committed to levy such a tax at the national level as from January 1, 2019. Hence the establishment of the tax event at the end of each civil year in the draft bill, to allow the DST to apply retroactively from the beginning of 2019.

Some MNEs likely to fall under the DST scope have raised concerns about the measures. In particular, it is difficult for some MNEs to determine among all the activities they were performing, which ones fell under the DST scope.

This difficulty was partially solved by the French Parliament which adopted amendments providing clarifications about the definition of taxable activities. For example, it provided a definition of ancillary services to be included in the DST scope, along with the express exclusion of logistics services marketed by companies providing a numeric interface for the provision of goods.

Another useful amendment excluded from the DST scope the provision of a digital interface when the provider is remunerated by users' subscriptions. This clarification is of importance as it ensures that the tax focuses on income sourced from the use of data of French users, and as a result that the DST merely applies to intermediation platforms and marketplaces remunerated by a commission fee in exchange for the interaction enabled between web users.

As to the risk of challenges to the DST, since it would be implemented in France as of January 1, 2019, these challenges, through future claims or litigations, could come in early 2020.

In particular, it could be questioned whether the DST should apply when a tax treaty exists, as it could be deemed to be of a similar nature as corporate income tax. Also, such a tax could be deemed by the Court of Justice of the European Union (CJEU) as a disguised and prohibited restriction, as in practice it will primarily apply to foreign companies, which would result in an unjustified difference in the treatment between local companies and foreign companies. Finally, even if the French DST has been designed as an indirect tax like VAT (to avoid the above-referenced tax treaty restriction), it could be considered that this qualification is artificial and indeed leads to a double taxation of the same turnover.

Speaking of double taxation, this risk could also result from the fact that the DST is being levied on the turnover of a company instead of its profits, implying that some income could be taxed twice. It could also result from the territoriality rule, according to which the intermediation service is taxable in France if the transaction induced by the intermediation involves a user located in France. Indeed, if the country in which the other user is located provides for the same rule, the same transaction could be taxed twice.

3. (a) In light of the proposed guidance outlined in the OECD's Public Consultation Document, Addressing the Tax Challenges of the Digitalisation of the Economy, what do you perceive are the key advantages of the i) profit split approach or the ii) fractional apportionment approach in tackling the challenges of the digitalization of the economy? (b) What are the challenges that you see, in practice, when applying these approaches considering the existing transfer pricing framework (e.g., feasibility of splitting profits between routine and non-routine, and then isolating those profits derived from a subset of marketing intangibles; reliability of the use of ''place of sales,'' ''number of employees,'' or other factors to spread the profit among jurisdictions; necessary information that should be available to taxpayers and tax administrations)?

Understanding how legal entities contribute to the value creation of a Group is an extremely difficult undertaking. This difficulty is increased if the Group operates a digitalized business model. It is further amplified if additional factors, external to the Group (e.g. user contribution) are to be taken into account.

We believe that the issue becomes inextricable if it consists of devising a simple, mechanical rule, applicable to all situations and able to withstand changes in business models and above all, the legal and operational adaptations of taxpayers to such a rule.

We do not believe that any simplistic or formulaic rule will be able to cope with the immense challenges raised by the digital economy. Such a rule would be quickly circumvented by taxpayers, if applicable at all.

In the case at hand, we fear that the transposition of concepts developed under the arm's length principle - such as "routine" activities – to an environment which would not ultimately rely upon the arm's length principle (such as the MRPS rule or in the Factional apportionment rule) would be bound to fail. These concepts may be somewhat loosely defined in the OECD Transfer Pricing Guidelines, where they relate to a web of concepts (such as comparability, etc.) which ultimately all relate to a very precisely defined (yet versatile) rule in the arm's length principle. Outside of the arm's length principle, the house of cards collapses. When concepts and definitions are removed from a solid and consistent framework, they are likely at risk of being circumvented.

The application of the arm's length principle has been bolstered by BEPS 1.0 (tackling base erosion and profit shifting situations). We believe that it remains the most promising route to address the concerns which lead to BEPS 2.0 (allocating tax bases more fairly between jurisdictions).

4. As the OECD works to develop a harmonized global approach to the taxation of the digitalized economy (anticipated in 2020), what are multinational enterprises (MNEs) in your jurisdiction doing to adapt their operations and business models, in light of the uncertainty during this period? Is it feasible for MNEs to isolate ''digital'' activity or to segment financial information by activity, product line, or region? Is this already done for purposes other than tax? If not, what would be the main obstacles to producing such information?

Based on our experience, MNEs are still taking a cautious stance toward the fast-paced evolution of the tax environment. They are especially sensitive to the impact that concepts developed or reactivated in the context of the digitalized economy (e.g. marketing intangibles) may have on other aspects of their activity.

Based on our experience, digital activity reporting is driven by business reasons and not by tax reasons. The ability of MNEs to identify, as an example, digital sales, may vary from one company to another, depending on the industry, internal organization, etc.

A number of B2B companies manage their e-commerce business separately. Yet, even in this case, in-depth analyses may be needed to create segmented P&L statements for digital and non-digital activities (if possible at all), insofar as – amongst many examples – (i) it is often the case that brick & mortar investments (flagship stores) directly fuel e-commerce sales or (ii) a non-digital sale to a third-party retailer may effectively be a digital sale from the retailer to the consumer, or vice versa.

Julien Monsenego is a Partner in Tax Law at Delsol Avocats; Margot Lasserre is an Associate in Tax Law at Delsol Avocats; and Guillaume Madelpuech is a Principal in the Paris Transfer Pricing Practice at NERA. They may be contacted at:

jmonsenego@delsolavocats.com

mlasserre@delsolavocats.com

Guillaume.Madelpuech@nera.com

www.delsolavocats.com

www.nera.com

