Transfer Pricing Forum

Transfer Pricing for the International Practitioner

Bloomberg
Tax & Accounting

NOVEMBER 2021

France

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1. Has your country put in place any tax measures (statutory or administrative) in response to the COVID-19 pandemic dealing with transfer pricing? Are those measures in line with the published OECD "Guidance on the transfer pricing implications of the COVID-19 pandemic"? How have these measures impacted taxpayers?

In response to the COVID-19 pandemic, France put in place several punctual measures regarding **different deadlines related to transfer pricing regulations** to address the urgent health situation:

- The **deadline for submitting the transfer pricing declaration form No. 2257-SD** for the fiscal year 2019 (normally due 6 months after the tax return deadline) was extended to 31 December 2020 (in connection with the extension of the tax return deadline). Companies not following the calendar year that benefitted from a deferral of filing their tax return were allowed a similar delay in filing form No. 2257-SD as well.[1]
- France approved the **six-month extension for reporting cross-border arrangements (DAC6)**, which was provided by Council Directive (EU) 2020/876. The deadline to report arrangements implemented between 25 June 2018 and 30 June 2020, was deferred until 28 February 2021.[2]
- The statute of limitation for the French Tax Authorities (hereafter "FTA") normally expiring on 31 December 2020 was suspended between 12 March 2020 and 23 August 2020. Thus, **the statute of limitation normally expiring on 31 December 2020 expired on 14 June 2021**.

The *OECD Guidance on the transfer pricing implications of the COVID-19 pandemic* (hereafter "OECD COVID-19 guidelines"), published in English on 18 December 2020 (and in French on 20 January 2021), covers the following four priority issues which have not yet been officially commented on by the FTA:

– Comparability analysis;
– Losses and allocation of COVID-19 specific costs;
– Government assistance programmes; and
– Advance pricing agreements ("APAs").

[1] Information provided in an update of the answers to the questions on the exceptional tax measures in favour of companies. This delay only applied for the fiscal year 2019 and does not apply for the fiscal year 2020 and onwards.
[2] For further information, see Winter 2020 / Spring 2021: Transfer Pricing Forum (April 2021, Bloomberg Tax & Accounting)

These various issues addressed in the OECD COVID-19 guidelines (as well as any other transfer pricing issues related to the pandemic) have not been the subject of specific formal communication by the FTA to date. Nevertheless, the OECD COVID-19 guidelines were developed and approved by the 137 members of the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting, which includes France.

Thus, the FTA should follow this guidance, as is generally the case with the OECD guidance.

Because no COVID-specific guidelines have been issued in France yet, and the feedback from tax audits or discussions with the FTA over APAs or other transfer pricing cases during this period remains fairly limited to date, our answers below are our interpretation of the likely impacts of the crisis on the French transfer pricing policies applied by the taxpayers and reviewed by the FTA.

2. The OECD Transfer Pricing Guidelines (TPG) observe that a downturn economy may trigger the need for business restructurings. How are MNEs in your jurisdiction coping with the current situation? Are they implementing short-term measures (e.g., reviewing and revising intercompany agreements in response to COVID-19) or more long-term and permanent measures (e.g., restructuring supply chains, etc.)?

In France, each MNE is facing specific economic challenges triggered by the COVID-19 pandemic. These challenges depend on the MNE organization, its sector of activity (some sectors such as hospitality, real estate, and food have been negatively impacted, while others have thrived during this period, notably in the Tech and Pharma sectors), its financial situation before the pandemic, etc.

MNEs in France put in place both short-term and long-term measures to respond to the unprecedented crisis of the COVID-19 pandemic.

Among the short-term measures (primarily addressed during 2020), MNEs focused on cash flow constraints in order to timely pay their suppliers and employees as well as the banks' interest charge and debts. To do so, some MNEs centralized the amount of cash available from each subsidiary at the level of the cash pool company to allocate the available cash as efficiently as possible within the group.

In addition, some subsidiaries were ordered to close during the lockdown, which led MNEs to temporarily reorganize their activities. MNEs also dealt with issues related to the procurement of goods/raw materials, transportation to production facilities, and delivery to customers.

Generally, some contracts were suspended (force majeure clause) or renegotiated (starting with certain lease agreements, or procurement agreements). In the context of transfer pricing, intra-group agreements may have been renegotiated in an attempt to respect the functional profile of each entity and to be as similar as possible to the situation that would have applied with a third party.

Among the long-term measures (primarily addressed from 2021), MNEs have been focusing on the adaptation of the group organization to be able to make the most of the economic recovery and to be prepared for any future crisis of this kind.

After the temporary restructuring to cope with the emergency of the situation, some groups began to redesign their organization for the long-term (e.g., restructuring of the supply chain, transfer of activity, etc.).

The health crisis also accelerated changes in consumption patterns through digitalization. In fact, e-commerce increasingly developed during the pandemic. For some MNEs, online sales have compensated for in-store losses. In order to adapt to the new scale of this trend (which already existed before the pandemic), companies undertook major restructuring within the group, which led to necessary adjustments from the transfer pricing perspective.

Some MNEs have also chosen to review their intra-group contracts (e.g., management fees, intangible royalties) in order to include profitability conditions.

Finally, several groups have undertaken a change in the cost structure to reduce or at least to variabilize the fixed costs to adapt to the gradual recovery of the economy (i.e., the back-and-forth evolution of the health situation, geographic differences). For example, the spread of remote work in the post-crisis period has a significant impact on the use of office space as many MNEs are reducing the number of square meters dedicated to on-site work.

3. Are companies facing challenges in their transfer pricing analysis (or benchmarking analysis) due to the economic impact of the global pandemic? Please consider the following discussion points, if relevant: location of personnel, PE issues, loss-making companies, supply chain disruptions, government assistance programs.

The publication of the OECD COVID-19 guidelines provided generic guidance regarding four main topics.[3] However, the lack of practical guidelines regarding certain questions related to these topics, as well as the lack of guidelines at all regarding other transfer pricing issues that were not addressed by the OECD led to significant difficulties for companies.

Regarding **supply chain disruption**, MNEs dealt with issues related to the procurement of goods/raw materials during the pandemic. Companies performed an overall business review of the supply chain restructuring in order to correspondingly adjust the transfer pricing methodology.

Regarding the **location of personnel**, under the new normal of remote work (including cross-border remote work), the ongoing presence of employees or managers in countries outside their usual places of employment could result in companies inadvertently creating **permanent establishments** in other jurisdictions (provided that the relevant conditions are met). Some companies even face the risk of a **migration of tax residency** through a change in the location of their decision makers.

The OECD recommended that temporary cross-border remote work situations related to the health situation should not be recognised as resulting in the creation of a permanent establishment. Nevertheless, remote work has generally become more permanent. Companies are making remote work the norm and

[3] See the four topics quoted at the beginning of the article.

some are even reducing the size of their offices. The assessment of cross-border remote work with regard to permanent establishment risk is therefore a new challenge that the MNEs will handle from 2021.

Regarding **loss-making companies** (especially entities considered as "routine" entities), companies have tried to adopt a case-by-case approach and to consider the origin of the sub-activity (such as realisation of a market risk or another risk related to regulatory constraints or supply difficulties).

The crisis revealed significant risks that had not been assessed in the value chain analysis. Historical functional analyses need to be reviewed to take into account the role of each party in managing the crisis and its impact on local business. In the context of crisis management, so-called routine entities, which are generally guaranteed a certain level of profitability, have sometimes had to make strategic decisions and thus deviate from their "routine" profile. Thus, these entities may bear a certain level of loss if it can be demonstrated that independent parties in similar circumstances have incurred similar costs and losses.

Companies performed case-by-case analysis to determine the situation of each entity. This has proved difficult given the complexity of the situation (unprecedented crisis, emergency decision-making) and the limited resources available to companies whose teams are already under stress to manage the business consequences of the crisis.

Regarding **major challenges related to benchmarking analysis**, because 2020 financial data will generally only be available in the databases by the middle or end of 2021, the gap period posed an issue for transfer pricing analysis. Several methodological approaches were applied by companies (micro-economic adjustments based upon the actual revenues and costs fluctuations of the company corroborated by a macro-economic analysis based upon the average revenues and costs fluctuations of the market, inclusion of loss-making comparables in the benchmark and/or application of a lower percentage in the interquartile range for example). These issues affect routine intragroup relationships but also business restructuring, in particular when it comes to valuating businesses or assets that are bought out / relocated internally.

Regarding **government assistance programs**, the OECD COVID-19 guidelines provide that these programs potentially have transfer pricing implications and give several examples; however, it is left to the companies to develop an analysis of the characteristics of such aid and its potential transfer pricing effects. Companies have therefore addressed this issue with uncertainty.

Regarding **existing APAs**, the FTA will likely consider case by case whether a breach in critical assumptions should lead to either a revision, cancellation, or revocation of the APA (otherwise APAs should remain binding). The discussion with the relevant tax authorities concerning the application of the APAs for fiscal year 2020 can prove a difficult exercise in practice. It is likely that the impact of the COVID crisis on APAs will be experienced in practice only in the coming years.

Finally, MNEs questioned the **invoicing of management fees and intra-group royalties**, in particular whether the prices charged for these transactions should be reduced or even waived. The **financing** conditions applied in controlled transactions (such as interest rate, etc.) also proved to be challenging in this unusual economic environment.

MNEs had to face the uncertainties described above and had to make tax-related choices at the time of the 2020 closing while the tax authorities will have more insight on the crisis when conducting audits in the coming years. We can only hope that the FTA will show understanding when conducting audits and that the positions taken in the different countries will be sufficiently consistent to avoid double taxation situations for companies that are already suffering from the crisis.

4. In relation to tax audits:

a. Have you seen, or do you foresee, an increase in transfer pricing tax audits as tax authorities may seek supplementary revenues as the pandemic subsides? How do you believe transfer pricing will compare to other tax issues as a target in a search for supplementary revenue?

Because of France's indebtedness following the aid granted during the crisis, it is possible to anticipate an increase in corporate tax audits and requests for information. Transfer pricing will likely remain a main focus of the FTA especially in the context of the COVID-19 pandemic, which has led to significant difficulties in defining the applicable arm's length prices.

In addition to the attention paid to the supporting documentation of the transfer pricing policy applied, the FTA will likely focus on the tax issues related to the health crisis.

- Among the tax issues directly related to transfer pricing, the FTA’s attention will likely focus on the evolution of the business model of MNEs and the consequences regarding functional analysis and allocation of taxable income/loss across the world.

The evolution of the MNEs’ situation during the crisis will be assessed by analysing the financial data of the sector, examining the functional analysis of the audited entity and benchmarks used to calculate transfer prices (including a review of the comparables and the relevance of the adjustments applied).

A thorough financial reconciliation will be key to demonstrating the proper application of the documented transfer pricing methods.

As mentioned above, the loss-making situations will draw the attention of the FTA, even more than before the crisis. These situations (loss-making situation of “routine” / distribution entities in particular) will be assessed with regard to the allocation of functions, assets, and risks between the group's entities.

Generally, exceptional operations carried out during the crisis (M&A transactions, transfer of activities) as well as management fees, financing intragroup transactions and treatment of government aid for transfer pricing purposes should be carefully analysed by the FTA.

Finally, the transfer pricing policy will be thoroughly reviewed in view of the contractual provisions of the intragroup agreements.

- Among the other tax issues with direct consequences on transfer pricing, the FTA will likely pay particular attention to the audit of permanent establishments. Remote work situations will be carefully analysed by the FTA to determine whether these situations should trigger taxation of the employer's activities in the country where the remote work takes place.

Finally, the global nature of the crisis may also encourage international requests for information between tax authorities in different countries bound by exchange agreements.

b. What actions are MNEs taking in anticipation of possible audits?

We can expect a willingness of MNEs to seek ways of supporting the transfer pricing policy applied during the pandemic.

The MNEs will have to **assess the changes to the group's business model**. Indeed, the identification of these operational changes will be necessary to analyse their impact on the allocation of functions and responsibilities within the group, to address the possible changes on the transfer pricing policy, and to collect the elements to justify the approach adopted during the pandemic. A **general assessment of the location of employees' working remotely** will also be useful to prevent the risk of permanent establishment.

Furthermore, the **transfers of activities** carried out in response to the crisis must be analysed in detail to determine the amount of compensation to be paid/received by the group entities involved and to avoid reassessments for these transactions.

In addition, a **detailed audit of intragroup contracts** will be necessary to ensure that the planned changes are in line with the contractual clauses. The involvement of the legal department is essential to confirm that the changes are consistent with the group's practice in its relations with third parties.

Moreover, the **supporting documentation** of the transfer pricing policy during this specific period is essential to justify the amounts of taxable results. This documentation should describe the changes that have affected the documented entity and include evidence of these changes.

- Companies should pay particular attention to the **consistency of the full transfer pricing documentation** (Master file, Local file, Country-by-Country Reporting, and annual transfer pricing return with the Form 2257-SD). Indeed, the different documents concerning the same entity must be consistent (i) with each other and (ii) with the documentation of the other entities of the group.
- Along with transfer pricing documentation, **increased communication with the FTA,** such as renewed interest in APAs (new agreement or renegotiation of pre-existing agreements), should be an approach considered by some MNEs to demonstrate their commitment to cooperation and transparency, and to further the development of trust with the FTA.

Finally, the MNEs are carefully monitoring the evolution of regulatory and administrative tax measures related to transfer pricing implications of the COVID-19 pandemic, as the situation remains uncertain with the development of new variants.

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