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France

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New documentation requirements were introduced at the end of 2013

I. New transfer pricing documentation requirements

A provision of the French law of December 6, 2013 against tax fraud has introduced a new transfer pricing documentation requirement, provided by article 223 *quinquies* B of the French tax code ("FTC ").

A. Applicable rules prior to the new provision

Since 2010, French transfer pricing documentation rules apply to entities established in France:

i. having a gross annual turnover or gross assets equal to or exceeding €400 million, or

ii. owning directly or indirectly at least 50 percent of an entity which meets the EUR 400 million criteria. This requirement also applies

iii. if more that 50 percent of the entity's capital or voting rights are owned, directly or indirectly by entities that meet the EUR 400 million criteria and

iv. to an entity which is a member of a consolidated tax group in France where one company of the group meets any of the above mentioned criteria. According to section L. 13 AA of the French Tax Procedural Code, these entities may be requested to produce their transfer pricing documentation in the course of a French tax audit. Failure to comply with this requirement can result in a penalty amounting to up to five percent of the reassessment.

B. New requirement

According to new Article 223 *quinquies* B of the FTC, entities which fall within the scope of the previous documentation rules will have to submit additional transfer pricing documentation within six months following the filing of their annual tax return. Therefore, there are now two documentation requirements:

i. the requirement introduced in 2010 under which the documentation shall be made available on request in the event of a tax audit and

ii. the new requirement under which the documentation should be provided spontaneously every year.

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In the latter case, companies with fiscal year-end on December 31, 2013 would have to provide the new documentation no later than November 2014.

The information to be provided under this new documentation requirement is not as extensive as that contained in the documentation which has to be provided on the beginning of a tax audit and shall include the following:

- General information regarding the group of related entities :
  - general description of the activities performed by the group, including any changes occurred during the concerned fiscal year;
  - a list of the main intangibles held in relation to the entity (patents, trademarks, trade names, know-how etc.);
  - a general presentation of the group's transfer pricing policy and any changes occurred during the concerned fiscal year.
- Specific information on the entity :
  - a description of the activities performed by the entity, including any changes occurred during the concerning year;
  - a summary of operations made with other related entities, classified by type and by amount, in situations where the aggregate amount per type of transaction exceeds €100, 000.
  - a presentation of the method(s) used to determine transfer pricing with respect to the arm's length principle, including the main method used and any changes that took place during the previous fiscal year.

Differences between information to be provided on the two current documentations requirements can be summarised as demonstrated in the table below.

Entities falling within the scope of this new requirement will have to prepare themselves to ensure that they are in a position to meet the six months deadline to submit their documentation.

II. Overview of recent case law

We provide below case law from the last year relating to French transfer pricing.

The French tax authorities places a lot of emphasis on auditing business restructuring cases, as well as changes of business model, and challenged them,

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Differences in documentation requirements		
Nature of information	Documentation to be provided in the course of a tax audit (Article L 13 AA of the FTC)	New documentation requirements (Article 223 quinquies B of the FTC)
General information about the group to which the French entity belongs		
General description of its business activity, including any changes occurring during the fiscal year	Yes	Yes
General description of the legal and operational structures forming the group identifying the related company engaged in the intragroup transactions	Yes	No
Description of the functions performed and of the risks borne by the related companies to the extent they have an impact in the audited company	Yes	No
Identification of main intangible assets having a link to the audited company (e.g. patents, trademarks, trade names, know-how, etc.)	Yes	Yes, by list of main intangible assets owned, particularly patents, trademarks, trade names and know-how, related to the French company
Broad description of the transfer pricing policy	Yes	Yes, including changes occurred during the fiscal year
Specific information about the French taxpayer		
Description of its activities, including changes that took place during the concerned fiscal year	Yes	Yes
Information on operations carried out with related parties, including nature and amount of flows (global flow per category of transactions)	Yes	Yes, by way of a summary of the transactions conducted with other associated companies, according to transaction type and amount, when the aggregate amount per transaction type exceeds €100,000
List of cost-sharing agreements, advance pricing agreements (APAs) and ruling obtained having an impact on the results of the company	Yes	No
Description of the transfer pricing method in compliance with the arm's length principle	Yes, with an analysis of the functions performed, of the risks borne, of the assets used and an explanation on the selection and application of the retained method of the audited company	Yes, but limited to the main method used and any changes made during the fiscal year
Where relevant, an analysis of the comparability elements taken into account in the application of the retained transfer pricing method	Yes	No

which was illustrated by recent court cases. It should also be noted that in two recent decisions, the French administrative court of appeal has confirmed transfer pricing reassessments based on economic dependence and on the taxpayer's failure to meet the burden of proof.

A. Business restructuring

The Administrative Appeal Court of Paris examined whether the intragroup transfer by a French company (Nestlé Finance France) to a Swiss related company (Nestlé Treasury Center Europe) of its cash pooling activity, without any compensation, constituted an "indirect transfer of profits abroad ", to be reassessed under French transfer pricing rules.[1,2]

The French company was in charge of the cash pooling management for the European entities of its group. In 2002, it transferred the current accounts of the French group companies to a Swiss related entity without compensation. The FTA considered this transfer constituted an indirect transfer of profits abroad pursuant to article 57 of the French tax code ("FTC"). The FTA accordingly increased the French corporate income tax base by the amount of the estimated value of the transferred activity and submitted it as withholding tax based on its characterisation as a deemed dividend distribution to the Swiss company.

In a decision dated May 11, 2011, the Administrative Court of Paris ("Tribunal Administratif de Paris ") upheld the position of the FTA and only modified the assessed amount.

In a decision of February 5, 2013 the Administrative Appeal Court of Paris invalidated the FTA assessment and the Administrative Court decision, on the grounds that the comparability analysis performed by the FTA was not reliable; the FTA had not detailed the comparable data used (name of the companies, comparability of the functions and information on the type and level of guarantees granted) and therefore, did not meet its burden of proof obligations.

However, the Court did not clarify whether a transfer of group internal functions should be compensated at an arm's length price.

The French Finance bill for 2014 aimed to answer these questions by introducing a new provision on business restructuring according to which a transfer of functions and risks must trigger compensation to be paid to the transferring entity, which has to prove that the transfer was made at an arm's length price. If the entity cannot demonstrate that the compensation received was appropriate, the FTA are entitled to add back the profit deemed to have been transferred. However, this measure was struck down by the French constitutional court due to the absence of definition of the concept of transfer of functions and risks.

The French tax treatment of a business restructuring seems to be unsecure and further clarification on this question would be welcome. In the meantime, attention must be paid to any transfer of functions and risks because the FTA are more likely to challenge such operation.

B. Change of business model

A conversion from one business model to another requires careful examination by the taxpayer because it may be deemed to be a taxable event.

The administrative court of appeal of Paris has recently stated that the conversion from a fully-fledged distributor to a commissionaire should not constitute a transfer of a clientele.[3]

In that case, a French company was a fully-fledged distributor of the products of a British company. In 1999, further to a change of a business model, the French company started to act as a commissionaire with a lower profit margin. No specific compensation was paid to the company on this conversion.

The FTA considered that this conversion was a taxable event under article 57 of the FTC because it resulted in a transfer of clientele.

In a decision dated December 10, 2009, the Administrative Court of Paris ("*Tribunal Administratif de Paris* ") upheld the position of the FTA.

However, the Paris Administrative Court of Appeal repealed the decision previously made by the lower court stating that a change to a commissionaire structure cannot lead to a transfer of clientele because a commissionaire is acting under its own name though on behalf of its principal. Therefore the commissionaire company still owned and exploited its clientele. The Court did not challenge the decrease of profit margin considering that it matched the new functions and risks assumed. The Court also noted that after the conversion, the French affiliate made a profit whereas prior to the conversion, it had incurred losses.

This decision is based on French commercial law under which a commissionaire remains the full owner of its clientele. The decision would certainly not have been the same in the event of a change to a sale agent structure, under which the agent sells the products in the name and for the account of the principal, triggering a transfer of clientele for the full-fledged distributor to the principal in the case of the conversion.

It should be noted that the French tax authorities have appealed this decision. Therefore, taxpayers should conduct a careful diagnostic of the change before implementation.

C. Administrative Court of Appeal uphold transfer pricing reassessments

Two French administrative courts of appeal have recently issued decisions affirming the transfer pricing adjustments.

In the first case, a French manufacturing entity entered into a contract with a Swiss entity under which the latter was granted the exclusive distribution of the French entity (the French company had handled the distribution itself before this contract). However, even under the distribution agreement, the management of the business did not change (the Swiss company was required to use the French company's logo and trademark and had to approve any promotional activities undertaken by the French company). No capital link was established between these two companies but according to the FTA, the Swiss company was economically dependent on the French company. As a consequence, transactions between them were subject to transfer pricing rules of section 57 of the FTC. The Administrative court of appeal confirmed the FTA reassessment, stating that:

i. the Swiss entity had only one employee,

ii. the entity paid no rent for any commercial premises,

iii. most of the functions assigned to the Swiss entity were routinely performed by the French entity, and

iv. the direction and control of the Swiss company were exercised by the French entity (i.e. the manager of the French entity had the Swiss entity letterhead and could access to the Swiss company accounting via his cellular phone).

Therefore, based on these facts, the court concluded that the French transfer pricing rules should apply.[4]

This decision is a reminder of the emphasis that needs to be put on substance. The declared functions and risks of a company can be duly documented contractually and factually, as otherwise, said company's existence or role can be challenged by the French tax authorities.

In the second case,[5] a French company had sold products to its UK and Netherlands sister companies at a lower price than it charged its unrelated customers. The sale price was challenged by the French tax authorities by using the comparable uncontrolled price method.

To justify the price applied, the French company had produced tables established by the US parent company showing that the UK and Netherlands companies had covered part of the transport, marketing and storage costs as well as some fixed general administrative costs. The French company also asserted that the tax authorities in Netherlands already audited the transaction using a different method than the method used by French tax authorities.

The Nantes Administrative court of appeal ruled that, under the French transfer pricing rules, once the French tax authorities established that there is a difference in pricing for transactions between related and unrelated entities, the French taxpayer, which has granted the advantage to related parties, is deemed to have made an indirect transfer of a benefit pursuant to section 57 of the FTC. The burden of proof falls therefore on the French taxpayer, which must demonstrate that the advantage granted is justified by counterparties.

In the present case, the Administrative court of appeal decided that the French tax payer had failed to justify the sale price applied because:

i. the production of tables was not sufficient to demonstrate that companies established in the UK and in the Netherlands had covered part of the above-mentioned costs; and
ii. and the company did not justify that the compensation received from its US parent corresponds to the advantage granted to the UK and the Netherlands companies. The Administrative court of appeal also considered that
iii. the French company did not demonstrate that the method used by the FTA was incorrect and
iv. the fact that the tax authorities of Netherlands have used a different method is irrelevant.

This decision illustrates again how the burden of proof can be shifted to the taxpayer. Therefore, it is important for the taxpayer to justify prices applied for transactions with related parties, by using a complete economic analysis and concrete documents (contracts, accounting entries, cost details etc.).

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1 *Cour Administrative d'Appel de Paris*, February 5, 2013, 10PA02914 and 12PA00468, Nestlé Finance International.

2 For more information, please refer to "France: The Nestlé Case" in Bloomberg BNA's *Transfer Pricing International Journal*, Vol.13, No, 9, September 2012.

3 *Cour Administrative d'Appel de Paris,* December 31, 2012, 10PA000748, Sopebsa.

4 *Cour administrative d'appel de Lyon*, July 11, 2013, chambre 5, no.11LY00678.

5 *Cour administrative d'appel de Nantes*, July, 25 2013, Chambre 1, no.12NT00223.