Bloomberg Tax

Transfer Pricing Forum

Transfer Pricing for the International Practitioner

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France

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1. Briefly describe the transfer pricing documentation and tax return disclosure requirements in your jurisdiction.

There are different levels of French transfer pricing documentation requirements depending on the size of the companies at stake (from smallest to largest entities):

1) *The common procedure* is covered by Article L13B of the French Tax Procedure Code ("FTPC"). This procedure is mandatory for small- and medium-size enterprises (SMEs) in the context of a tax audit, and when there is an assumption that a transfer of benefits has occurred. The administration may request the following information from the company within a minimum period of 2 months:

- The effective nature of the activity, the way it was carried out, and the risks assumed;
- The resources used (personnel, fixed assets, intangible assets, balance sheets, income statements by product, margins generated, composition of assets and expense accounts);
- The transfer pricing method and the elements justifying it;
- The tax regime applied to transactions carried out by foreign affiliated companies.

2) *The Transfer Pricing Reporting Form* is obligation under Article 223 quinquies B of the French Tax Code ("FTC"). The form is mandatory for entities with total net sales or total gross assets exceeding €50 million. The entities are required to submit a tax form n°2257-SD electronically within 6 months following the deadline of the filing of the annual tax return. The 2257-SD tax form requires the disclosure of:

- general information regarding the group of related entities (e.g. activities performed, a list of the main intangibles and a general description of the Transfer Pricing policy conducted by the group); and
- general information regarding the entity itself (e.g. operations undertaken with related entities in excess of EUR 100,000).

3) *The Transfer Pricing Documentation Requirement* is an obligation under Article L13AA of the FTPC for entities with total net sales or total gross assets exceeding €400 million. Taxpayers must provide their transfer pricing documentation upon a tax inspector's request, i.e. in the context of a tax audit. The list of information to be provided has been significantly extended by the 2018 Finance Act, which adopted the BEPS project proposals.

- Master File: gathering information about the whole group, it is the same in every jurisdiction where the documentation is displayed.
- Local File: comprised of specific analysis about the transactions of the entity being audited. It is specific to each State where a company group is established.

The Transfer Pricing Documentation Requirement has been closely aligned with the provisions of Chapter V of the OECD Guidelines.

Other requirements apply to companies having transactions with companies in territories on the list of "uncooperative" territories (Article L13AB of the FTPC).

4) *The Country by Country Reporting* is a requirement under the provisions of Article 223 quinquies C of the FTC ("CBCR"), for large multinational groups generating an annual turnover of at least €750 million. This declaration must contain *inter alia* (i) information on the group profits and (ii) information on the location and activity of the entities of the group. It should be filed within 12 months following the end of the fiscal year.

2. In recent years, have the tax authorities changed or modified their audit approach? (e.g., increase in staffing and/or increase in funding with respect to the transfer pricing audit function; use of risk assessment tools or data mining tools to identify audit targets; use of joint or coordinated audits, etc.). If risk assessment tools are used, what factors are typically analyzed?

We have identified the following trends in tax audits by the French Tax Authorities ("FTA") related to transfer pricing:

- There in an increase in controls aimed at demonstrating the existence of a French permanent establishment (PE) linked to a foreign parent company, particularly in the digital sector or on marketing "support" structures, and the corresponding increased use of tax raid procedures to gather factual

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and financial elements to allocate profits using Transfer Pricing models to these re-characterized French PEs;

- Apart from the international tax audit unit ("DVNI") who traditionally specialized in transfer pricing audits, an increased number of tax inspectors from local tax audit units now include transfer pricing as a major item on their audit list, and require the documentation very early in the tax audit process. These local inspectors do not necessarily use the support of the DVNI for their Transfer Pricing analysis;
- The requirement to submit at the tax audit kick-off meeting the electronic accounting files of the audited French company allows the tax inspector in charge to begin performing computations and reconciliations for Transfer Pricing purposes, and to identify any mismatch or inconsistency;
- The FTA tend to give specific interpretations of contractual agreements between related parties leading to transfer pricing adjustments, even if they are difficult to sustain from an economic point of view. For instance, we had recent experiences where the FTA considered that the remuneration of a French service provider should have been maintained on the basis of a contract that had not been properly terminated, even if the service was no longer provided. In a similar "legalistic" approach, the FTA considered in another case that the same cost, used for two separate services, should have been included twice in a cost-plus basis, on the grounds that the contract was poorly drafted and unclear on this matter, even though it is obvious the same cost cannot be remunerated twice.
- The FTA is more and more inclined to use its rights of communication vis-à-vis:
- Other foreign tax authorities, either to get information of certain APAs, rulings or other specific position, or more generally to ensure a certain income flow has been taxed or charge flow has been deducted;
- Clients or suppliers, to confirm certain operations' consistencies or, in the case of PE characterizations.
- There is also an increase in seizures of bank accounts before or during tax audits, in particular on French subsidiaries of foreign companies. This is a demonstration of the willingness of the FTA to ensure that it preserves its financial rights over the reassessments it deems correct and due. This leads to intricate reimbursements procedures if and when these reassessments are dropped, in all or part, at a later stage.

Finally, a trend which is likely to grow exponentially in the coming years is the use of social media and consumer data, notably for the FTA to characterize a French taxable presence of non-established foreign companies and groups, either using the current PE approach, but also in the light of a future possible digital PE approach or the recently-announced French GAFA (Google, Apple, Facebook, and Amazon) tax, aiming at digital services.

3. Do the tax authorities focus on certain types of transactions? (e.g., intangibles, financing transactions, commodities, etc.).

The FTA are increasingly scrutinizing intangible-related transactions. In particular, evolutions in business models which may have resulted in the transfer of unrelated or related customer lists are often subject to thorough reviews by field auditors.

The FTA is also known to take a more aggressive stance with regard to loss-making headquarters of French-based MNEs. The cost base of such headquarters is increasingly reviewed to make sure that all the activities which could result in service charges at arm's length are indeed properly treated by the taxpayers.

4. Do the tax authorities rely on BEPS-related concepts during its audits? (e.g., DEMPE analysis, new approach for hard-to-value intangibles, expanded use of profit splits, use of risk assessment framework, etc.).

Based on our experience, the position of the FTA may vary from one tax audit to another, depending on the individual experiences of the field auditors, as well as - according to certain practitioners - the very interest of the FTA in the case at hand.

The use of the concept of "economic ownership" by the FTA in certain instances predates the introduction of the DEMPE framework by the OECD. Taxpayers should be ready to demonstrate how their transfer pricing policies comply with the DEMPE framework. In particular, the "abnormal act of management" framework in France, enables the FTA to consider, in practice, the options realistically available of the French taxpayer, even without relying upon the Article 9 of the Tax Convention or on the French transfer pricing domestic regulations.

The FTA are also increasingly using high-level profit split analysis in the context of tax audits. This trend is likely to be reinforced as a result of the availability of the CbCR data.

5. Do transfer pricing penalties apply in your jurisdiction? If so, what can be done to mitigate these penalties?

French law provides for different penalties depending on the type of transfer pricing documentation:

- With respect to the common procedure to be applied during tax audits, if the company fails to provide the relevant information within the deadline, the company risks a fine equal to €10,000 for each financial year covered by the request, and a reassessment of its tax base pursuant to article 57 of the FTC.
- With respect to the transfer pricing reporting form, failure to file the n°2257SD tax form may lead to a penalty of €150. For each error or inaccuracy, the company incurs a penalty of €15 with a minimum penalty of €60 and capped at €10,000.
- With respect to the transfer pricing documentation (Local File and Master File) to be provided in the course of a tax audit, failing to do so may result in a penalty of the greater of:

(i) 0.5% of the amount of the transactions for which only partial or incomplete documentation has been provided to the FTA or

(ii) 5% of the amounts reassessed by the FTA with regard to these transactions,

with a minimum of €10,000 per reassessed fiscal year.

- As for the CbCR, failure to submit the relevant report will attract penalties up to a maximum of €100,000, for each instance of error or inaccuracy, the company incurs a penalty of €15 with a minimum penalty of €60 capped at €10,000. It is important to note that such a penalty is likely to apply to the French Mother Company responsible to file the CbCR, not to a French subsidiary of a foreign parent company preparing the CbCR supporting documentation itself.

If the relevant documentation is not provided to the FTA in a timely manner, it may be difficult to mitigate the above-mentioned penalties. Therefore, the best way to avoid those penalties would be to anticipate and prepare the required re-

ports in advance, so the relevant information might be delivered to the FTA within the required timeline.

Furthermore, in practice, the failure to comply with the provisions of article L13AA may also lead to a reversal of the burden of the proof, in the event of a litigation.

Finally, in case of a transfer pricing reassessment following a tax audit, pursuant to article 57 of the FTC, the FTA can add back to the taxable income of a company any profits transferred to a foreign related company via increases or decreases in purchase or selling price, for example. In addition to the reassessment, companies will incur the late payment interest amounting to 0.2% per month, plus the potential 40% penalty where the good faith of the entity is challenged, or even 80% if fraud is established. In addition to transfer pricing adjustments, the FTA can levy withholding tax on deemed distributed revenue, the amount of which is to be determined depending on the applicable double tax treaty.

6. Please describe any challenges taxpayers face in preparing their transfer pricing documentation in light of these changes in the audit process.

Given the increasing amount of information to be provided, the level of accuracy required and the sanctions attached, taxpayers should prepare the documentation in advance, and set up internal procedures to systematize the exercise and make the collection of information easier.

Another risk relating to a poorly drafted or even a lack of documentation is the ability for the FTA to disregard the submitted Transfer Pricing elements as non-opposable and to formulate its own transfer pricing position and reassessments, shifting the burden of the proof to the taxpayer.

More specifically, we have seen in recent years difficulties for:

- French groups coping with the "layering" of French tax legislation, meaning yearly additional new or revised compliance obligations, impacting the contents of the Master File, Local File or CbCR reporting;
- French subsidiaries of non-French groups being aware that they are subject to certain Transfer Pricing obligations, such as the CbCR requirements (i.e. the need to disclose the parent company in charge of making the CbCR reporting on the Group's behalf), or even that they need to prepare a Local File.

It is important for companies to address this lack of internal or external communication. In addition, the FTA should update the transfer pricing guide (which has not been updated since November 2006) and publish more newsletters to taxpayers on these matters. Taxpayers should ensure that the parent company and local advisers (notably accountants and lawyers) make a more systematic check of the transfer pricing compliance obligations of the French subsidiary.

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