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Transfer Pricing Disputes Likely to Increase in France due to Budget Deficits

By Cyril Maucour

Foreign companies with operations in France have been experiencing or most certainly will experience a tax audit in France as the French Tax Authorities (FTA) tend to regularly audit French companies.

The FTA have been very active in the audit field as the total amount of notified adjustments, including principal penalties and interest, was in the range of EUR 17 billion in 2012. The current economic climate and the inability to maintain deficits under 3 % create a strong incentive to find additional money to fund the treasury. In the meantime, the level of taxation (as high as 46.5 % of France GDP) does not give opportunities to raise new additional taxes.

The French government will have to reduce its costs but also repatriate tax that was avoided through international tax planning. The Ministry of Finance officially announced that the audit revenue target for 2014 will be raised by EUR 6 billion (i.e. a 30 % increase in companies with 2012 figures).
In this respect, the FTA has always been very active in adjusting transfer prices between related companies to try to recapture tax base that is considered as having been "unduly eroded" to the benefit of low tax jurisdiction (including but not limited to Ireland, Luxemburg, Switzerland and the Netherlands).

As a result, the FTA still considers that the allocation of tax base under the tax treaties is in many cases inappropriate and provides very abnormal results.

In the Base Erosion and Profit Shifting (BEPS) action plan presented by the OECD on 19 July 2013, four actions out of 15 concern transfer pricing giving additional comfort to the tax authorities in their perception that transfer pricing rules have been, in many situations, used as a mean to reduce the effective tax rate of multinational companies.

Also, dematerialisation of the supply chain of the so called "GAFA" (Google, Apple, Facebook, and Amazon) is considered to be inappropriately addressed by international tax concepts under the OECD model convention and the French tax administration is trying to find a way to levy the "right" amount of tax for the operations being conducted in France by these international groups.

Many of these international groups will be/are facing aggressive audits (sometimes coupled with tax raids) and adjustments for very high amounts. Besides, criminal ramification may also stem from such audits as resulting from tax fraud, even though for the time the FTA rarely uses such approach.

Finally, transfer pricing documentation obligation will change and (under the current draft law), companies falling in the scope of the obligation (i.e. companies having a total of revenue or gross asset of EUR 400 M or being owned by an entity; or groups meeting this threshold) will have to file contemporaneous documentation with their FY 13 tax returns.

For all these reasons, preparation in anticipation of tax audits is key for foreign companies investing and running operations in France so as to avoid getting caught.

General trends observed in audits can be summarised as follows:

- (i) Transfer pricing (TP) is a strong area of focus. Documentations have to be prepared in advance of an audit. Besides maintaining TP documentation, the local subsidiary should also constitute a defense file to be used in the course of discussions with the French tax authorities;

- (ii) Losses carry forward are scrutinised by the FTA and they have the effect to extend the statute of limitation beyond three fiscal years (the year when the losses have been generated can be audited when there is a loss carried forward) ;

- (iii) VAT is also analysed in details.

- (iv) Any penalty that can be applied is levied as the tax authorities know that a litigation on a penalty is not easy to successfully process (except for penalties attached to a CIT or VAT adjustment)

- (v) PE are more and more addressed as an alternative to a TP adjustment

Practitioners have also experienced that negotiating a settlement is getting harder once the notice of adjustment has been issued.

In this respect, discussions with tax inspectors during the audit are key to resolving issues. Nevertheless more and more field inspectors are following instructions from their hierarchy in tax audits and have thus no potential to close issues that have "officially" been requested to be deeply enquired.

In the administrative phase (i.e. after notice of adjustments has been issued), settlement opportunities exist but are becoming more and more difficult to use, as the FTA tends to support field inspectors. Also, when the amount of tax claimed is significant, decision on a solution has to be escalated through the hierarchy of the FTA (up to the Ministry of Finance). For this reason, a settlement with the FTA has to be based on technical and economic arguments provided by the taxpayer.

Besides, the political crisis after the Cahuzac case (the French Ministry of Finance had to finally admit that he held an account in Singapore that was never declared to the French government) generated pressure on the tax authorities to base settlements on technical grounds so as to avoid criticisms for partial tax treatment.

The case may also be handled through the competent authority. In this respect, late interest does not apply between the filing and decision of the competent authority. Nevertheless, a draft law, currently in front of the French Parliament, may change this situation so that interests would apply. Even though the competent authority route cannot address all situations (it may not provide an adequate financial remedy or cannot be used in case significant penalties have been applied) it remains a valid option in many situations.

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