Global Tax Alert

News from Transfer Pricing

New French transfer pricing package entails a second, contemporaneous, documentation requirement

Executive summary

As part of the surge in government initiatives to address Base Erosion and Profit Shifting (BEPS) concerns, the French authorities recently released a broad package of measures with far-reaching consequences with regard to transfer pricing and international taxation.

This Alert - after a brief overview of the French transfer pricing regulations already in force - specifically addresses the 2014 Finance Bill. Following the final adoption on 19 December 2013, by the French National Assembly, the bill was examined by the Constitutional Council that handed down its decision on 29 December 2013 and held several measures to be contrary to the French Constitution. The 2014 Finance Bill was officially published the next day and thus, it has now come into force as of 31 December 2013.

In addition, on 4 December 2013, the French Constitutional Council validated a new contemporaneous transfer pricing documentation “light“ requirement included in the Fight Against Tax Evasion and Financial Criminality Bill adopted by French Parliament on 5 November 2013. The Bill was officially published on 7 December 2013. “Light“ refers to the fact that the transfer pricing documentation that will need to be lodged at the latest within six months of filing the tax return is “reduced“ transfer pricing documentation as it will, notably, not include the obligation to disclose comparable studies.

Detailed discussion

Existing French transfer pricing documentation framework

Since enactment of the amended 2009 Finance Bill, a transfer pricing documentation requirement exists in France for fiscal years open as of 1 January 2010 under the provisions of Article L13AA of the French Procedural Tax Code (FPTC). As
such, companies or permanent establishments that satisfy any of the criteria listed below have to provide their transfer pricing documentation within 30 days upon first request made by the tax inspector in the course of a tax audit:\(^3\)

- Have total net sales (before taxes), or total gross assets, equal to or greater than €400 million;
- Hold, directly or indirectly, at the closing date of the fiscal year, more than 50% of the capital or voting rights in a legal person having such turnover or gross assets;
- Are, on the closing date of the fiscal year, more than 50% held, directly or indirectly, by such legal person; or
- Belong to a French tax consolidated group that includes at least a legal person that meets one or more of the aforementioned criteria.

Consequently, irrespective of the materiality of their operations in France or of their intercompany transactions, most large multinational enterprises (MNEs) must prepare an L13AA transfer pricing report. Such report must cover the following items:

- A description of the group, its products, services and business strategy, including a focus on the French entity under review (i.e., description of the activities undertaken, legal charts, agreements, changes that occurred in the preceding year);
- An industry analysis describing the main specificities of the sector in which the group and the entity under review are engaged (i.e., market trends, competitive landscape);
- A list of intangible property being owned and exploited with regard to the intra-group transactions being documented;
- A description of the cross-border intercompany transactions in which the covered entity is involved, as well as the transfer pricing policies applied;
- A functional analysis determining the functional profile of the French entity and its counterparties in the intercompany transactions under review; and
- If relevant, economic analyses supporting transfer pricing methods and policies selected by the company.

The introduction of this regulation already had major consequences on the way intercompany transactions ought to be documented in France. A thorough local functional analysis is now expected from the taxpayer, as well as the documentation of all intercompany cross-border transactions, including for instance financial transactions or non-recurring transactions such as business restructuring.

Introduction of a new contemporaneous transfer pricing documentation requirement

The Fight Against Tax Evasion and Financial Criminality Bill that entered into force on 8 December 2013 introduced an Article 223 \textit{quinquies} B in the French General Tax Code that substantially reinforces the French transfer pricing documentation requirements. Taxpayers filing their Corporate Income Tax (CIT) return as from this date and that are subject to the above-mentioned provisions of Article L13AA of the FPTC must - in addition to the preparation of an L13AA report - file “light” transfer pricing documentation, at the latest six months following the deadline for filing their CIT return - i.e., nine months following the closing of the fiscal year (FY). The “light” transfer pricing documentation should provide the following information:

- General description of the group (activities undertaken, main intangible assets owned in connection with the French taxpayer, transfer pricing policy applied, changes that occurred in the last FY); and
- Specific information regarding the French entity (activities carried out, changes in the last FY, list of the inter-company transactions if the aggregated amount per type of transaction exceeds €100,000, presentation of the transfer pricing methods used for determining arm’s length transfer prices, changes that occurred in the last FY).

As such, no detailed functional analyses or economic analyses will be required in this “light” documentation report and the penalty for a breach of this provision is minimal (€150). However, the
purpose of this new provision is to be understood as the enhancement of the French Tax Authorities (FTA) capability to identify taxpayers with the highest transfer pricing exposure so as to allocate their audit resources accordingly. Such an approach - where taxpayers failing to file the report would of course be highly scrutinized - is in line with the latest OECD developments described in the White Paper on Documentation.4 Accordingly, the preparation of this “light” documentation report should therefore be seen as an important extension to the overall - already existing - obligation of documenting intra-group transactions in France.

Provisions introduced in the 2014 Finance Bill

Communication of the analytical and consolidated accounts in case of a tax audit
After enactment of the bill, companies in the scope of L13AA or with a turnover exceeding €152.4m or €76.2m depending on their business activity will have to communicate their management accounting in case of an audit. The precise definition of the management accounting should be further clarified in future additional regulatory guidance.

French holdings will also have to disclose the detail of their consolidated accounts, allowing the FTA to identify for instance the tax provisions.

These provisions are additional to article L47A1 of the FPTC which makes mandatory, for all tax audits opened as of 1 January 2014, for taxpayers to communicate their computerized accounting - where the company is required to maintain such computerized accounting. Article L47A1 provides for a very precise formatting of the data.

Currently, the penalty for a failure to comply with these provisions will be limited to €1,500.

Requirement to disclose foreign rulings in transfer pricing documentation
It is required for taxpayers that fall within the scope of Article L13AA of the FPTC to include in their transfer pricing documentation, tax rulings (as defined in French tax law) obtained by all related parties from foreign tax authorities, as from the entry into force of the 2014 Finance Bill. In practice, as per the Constitutional Council, the requirement does not cover documents obtained from foreign tax administrations and that would not be available to the French taxpayer.5

In case of MAP, requirement to make the payment of the additional taxes before the end of the procedure
Current French regulations provide for a postponement of the payment of taxes resulting from a French transfer pricing reassessment (L189A of FPTC) in case of opening of a mutual agreement procedure (MAP).

The bill terminates this provision for MAPs opened as from 1 January 2014. It will thus no longer be possible to defer a direct cash impact following a French transfer pricing reassessment by opening a MAP.

Increase of the ETR to 38%
The temporary additional contribution to CIT is increased from 5% to 10.7%, applicable to FYs ending between 31 December 2013 and 30 December 2015, and to companies (or tax consolidated groups) with an annual turnover exceeding €250m. ETR thus amounts to circa 38.0% (standard rate of 33.1/3%, increased by the 3.3% social contribution and the 10.7% temporary additional contribution) instead of the current 36.1%.

Anti-hybrid arrangements mechanism6
In light of Action No. 4 of the BEPS project released by the OECD on 19 July 2013, the French Government proposed to disallow the tax deduction of interest accrued to related parties if the French taxpayer cannot justify - at the request of the FTA - that the lender is liable to CIT on such interest that amounts to at least 25% of the CIT that would have been due, had the lender been established in France. This new rule applies to FYs ended as of 25 September 2013.

Provisions introduced in the 2014 Finance Bill Provisions but declared unconstitutional
Shift of the burden of proof to the taxpayer in case of business restructuring
It was proposed to reverse to the taxpayer the burden of proof if, simultaneously (i) the taxpayer was engaged in a business restructuring operation with related parties, (ii) functions and/or risks were transferred or terminated, in a
very broad sense; and if (iii) the taxpayer’s operating income in one of the two FYs following such operation was at least 20% lower than the average over the three preceding FYs.

The Constitutional Council rejected the application of this measure, as it considered that it was based on unclear provisions that did not satisfy the principle of intelligibility of the law.

In practice, it remains that it is recommended to taxpayers (including those that do not fall within the scope of Article L13AA of the FPTC) involved in business restructuring to prepare a documentation to support (i) the existence and (ii) the arm’s length nature of the compensation aforementioned. Although the FTA still bears the burden of proof, such documentation will facilitate discussions with the administration in case of tax audit. It is further likely that a future law will be drafted to address these constitutional concerns, but the message from the FTA is clear: business restructuring transactions are and will continue to be scrutinized.

**Extension of the General Anti-Abuse Rule and disclosure of aggressive tax planning arrangements**

The scope of the French general anti-abuse rule (GAAR) would have no longer be limited to transactions that are “exclusively” tax driven, but rather extended to “principally” tax driven schemes.

Furthermore aggressive tax planning schemes would have been subject to mandatory disclosure, before their implementation by both taxpayers and advisors.

Both measures were ruled unconstitutional by the French Constitutional Council on the grounds that they were too broad and lacked clarity.

**Increase of the penalty for failure regarding L13AA transfer pricing documentation requirements**

Companies that fall within the scope of Article L13AA of the FPTC would have been subject to a penalty increased to 0.5% of their turnover, per fiscal year audited, potentially in case of lack or incomplete L13AA documentation report and with a €10,000 minimum.

The Constitutional Council censored this provision, on the grounds that the penalty was potentially not commensurate with the severity of the breach.

**Reinforcement of the treatment of the transactions with non-cooperative states or territories**

The transfer pricing regulations would have been extended to transactions between French companies and companies established in non-cooperative states or territories, regardless of any link of control or dependence between the French taxpayer and the foreign entity.

This provision was ruled to be contrary to the French Constitution as part of the package on business restructuring.

**Implications**

By introducing this new round of regulations, France intends to place itself at the forefront of the G20 initiatives against tax avoidance, pre-empting the conclusions that the OECD will provide, for instance on measures against hybrid arrangements (Action 2 of BEPS Action Plan, expected September 2014).

The introduction of an additional, and this time contemporaneous, transfer pricing documentation requirement will significantly change the French transfer pricing landscape by empowering the FTA with a complete toolkit to quickly identify and characterize audit opportunities: increased transfer pricing documentation obligations; use of widely publicized police raids⁷ at taxpayers’ premises; access to management accounts; and a facilitated access to financial data in easily manipulated electronic format.

Taxpayers are well-advised to consider this series of new French reporting/compliance obligations and to closely follow further developments in the French and international tax landscape as BEPS measures are implemented across and beyond the OECD.
Endnotes


3. A 30 day extension can be requested of the tax auditor, who can decide to grant or not the extension.


7. Legislation reinforcing the legal powers of the FTA when having recourse to such police raids passed earlier and a notable increase in police raids at corporate taxpayer premises have been recorded.
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