Tax News and Horizon Scanning Podcast Series on Tax Disputes

Episode 6: Tax Disputes in France

Zoe Andrews	Hello and welcome to our tax dispute series. I'm Zoe Andrews Co-host of Slaughter and May's regular tax news podcast. Across the world, tax risk is on the rise. What should you be concerned about and how can you prepare? This podcast series takes you on a journey to G20 countries across 6 continents to answer these questions. I'm excited to stop off at France for this episode. This podcast will be relevant to you if you're involved in a tax dispute with France or are trying to avoid getting into a dispute in France or even if you currently have no business concerns in France but take an interest in the global tax disputes landscape, particularly the recent trend of criminalisation of transfer pricing matters in France. I'm delighted to be joined by my colleague, tax partner Charles Osborne and Julien Gayral, a tax partner at Bredin Prat who's joining us online from France. Thanks for joining us today. Julien, please tell us a bit about yourself and your tax disputes practice.
Julien Gayral	Hello, I'm Julien Gayral, partner at Bredin Prat law firm, Bredin Prat is comprised of 30 lawyers, among which you'll find 7 partners, including myself. We developed unrivalled expertise in handling and assisting clients in relation to what we would call high stakes tax controversies, and this goes, of course from initial discussions or negotiations when clients face tax audits. One specificity of our team is that we've been developing over time a quite unique relationship with the tax authorities in order precisely to be able to assist clients when we need to find settlements. Myself, within this team, I've been a partner for 15 years within the Bredin Prat tax team and especially focusing myself, aside from the global M&A practice on assisting clients in connection with what we're talking about today, i.e. tax disputes and litigation.
Zoe Andrews	Charles, would you like to tell us about yourself and your experience of managing HMRC inquiries and disputes?
Charles Osborne	Thanks Zoe. Yeah, I started my career at the Bar actually in the UK and so disputes was my focus originally. I then jumped ship over to working at Slaughter and May in 2013. I have a very broad practice doing everything from advising on tax consultancy matters, M&A, debt and equity markets and of course, tax disputes remains a very big part of that practice. Tax disputes for us involves everything from the inquiry stage, the pre-litigation stage, all the way through to assisting clients in court, in full blown litigation and for the purposes of what I think

	we're going to talk about today, transfer pricing remains a very important part of that disputes practice here for us in the UK. So to be to begin with Julien, maybe one area we can focus on and ask about is the issue around the scope of corporate tax base, which remains something domestically and cross-border that is subject of dispute. As France is the only EU jurisdiction in our podcast series, we wanted to take this opportunity to ask you about the EU Commission's flagship corporate tax policy to introduce a new single set of EU wide rules to determine the tax base of large groups of companies. I can see how that might seem like an attractive simplification, which could reduce the number of tax disputes - but is it really something that's likely to happen, or is this just going to be another failed proposal for a common corporate tax base?
Julien Gayral	The Commission, of course, has been issuing a lot of proposals and I would say that with the objective, of course, of trying to harmonise and create a uniform tax basis for all countries. And the difficulty we're facing, and this is presumably the reason why we do not really see how this is going to implement itself, is that we've had over the last year, some successive layers. Of course, we have Pillar One, Pillar Two and now some new proposals, namely the BEFIT and Unshell directives. These two tools, which add to all the tools we already have, presumably will not necessarily be enacted very soon from our perspective, especially since, first of all, from a pure French perspective, if I take the example of the Unshell proposal. It's interesting, it basically stresses some substance test to determine whether or not a company is effectively where it should be. But this is quite far, in fact, from the sophistication that we do experience with the French tax authorities, which do not consider that a company, because it has an office, people, somewhere will necessarily be deemed to be where it's deemed to be. I think the tax authorities, especially on those kinds of issues, will have a look to the rationale underlying the creation of structures in different countries rather than the material and human means being available to it. So, we're not absolutely sure that this directive, first of all, will be enforced and in any event from our perspective and I think that this is presumably a consensus of the sophisticated tax countries we do have within Europe, that this will not be that efficient in light of the current practice of the tax authorities. BEFIT raises from my perspective, something a bit different. It's deemed again to create some harmonised tax basis, but it comes on top of previous legislation which basically has more or less the same aim and what we're currently facing today is to struggle to see how this new layer of legislation is going to interact with the previous ones because they are providing for different rules of determining the taxable basis. Basically, long story short, in that respect it's creating for now more of an additional layer of complexity where the underlying rationale of all this legislation was, on the contrary, to try and find something clear and workable for old legislation to share the same cake, if I may say, and it's not going to work that way. It's more creating some complexity, and this is presumably the reason why

	there has been so much discussion about that without real hope that this will come to something credible.
Charles Osborne	Yeah, totally makes sense. I mean, it sounds like the same story we've heard on a number of different pieces of EU legislation in the past few years, many of which have just sort of disappeared as a result.
Julien Gayral	Exactly.
Zoe Andrews	Let's move on to our main topic, Julien. What would you say is the greatest tax dispute risk in France right now?
Julien Gayral	Transfer pricing, especially when talking to multinational groups, is definitely the area of concern as we speak. For instance, in France, if we look at the figures being released by the tax authorities themselves for 2022, 60% of the taxable basis which have been reassessed one way or the other by the tax authorities in an international context relate to transfer pricing matters.
Zoe Andrews	And what's causing such a high percentage of transfer pricing cases? Is this just extra scrutiny by the French tax authority, or is there something else going on here?
Julien	So, I think that it's more of an evolution of the economy, basically, where the economic model of the multinational of course raises some concern as to the demand, how the added value of all the operation of such goods should be captured and assessed and determine if and to what extent the contribution of the French piece of this multinational should be properly remunerated for that. Of course, this is tied to the budget of these countries, and France is here again, no exception. They want to collect as much money as possible and have, presumably the feeling that they are losing a lot of taxable basis, such feeling being increased by media, Parliament and all the noise around that, considering that the lack of resources is in some way caused by the way the tax organisation of multinational groups is trying to avoid paying taxes in countries where the taxes are deemed to be high. And France, of course falls within the scope of these countries.
Zoe Andrews	And I understand that the public prosecutor can also open criminal investigations on transfer pricing matters in certain circumstances. Can you explain when this would happen?
Julien Gayral	Yes, you had in 2018 the introduction of what we call in France, the Anti-Fraud Act. The principle is that a tax case will be automatically transferred to the public prosecutor if certain conditions are met. These conditions are pretty simple, and in fact quite easy to reach. The first condition is that you need a case which leads to collections of reassessed taxes of at least €100,000, which is when we're talking about multinational is in fact pretty easy to reach. The second condition is that such tax reassessment needs to be coupled with penalties. The first one is what we call the 80% penalty, so basically penalties being triggered when you are

	confronted with a case that the tax authorities consider to characterise an abuse of law or fraudulent manoeuvres. This is the first case. Of course, this concerns in practice limited cases. The more frequent and more dangerous one, if I may say, is the second one. Still the same conditions as far as the amount of tax reassessed €100,000. The second condition is that if this reassessment is coupled with 40% penalties that apply when you are in the case of wilful misconduct and that the same taxpayer has suffered during the six preceding fiscal years a similar penalty or higher one or an investigation from the tax authorities, then the second occurrence of penalties will trigger the transfer of the case to the public prosecutor. If the amounts are important, the taxpayer is a sophisticated one and the structure is complex, of course, this will ease the demonstration of the tax avoidance to consider that you could not ignore what you were doing. It's all the more difficult and dangerous where you have basically two occurrences of penalties within a six year period and given the statutes of limitation, you could potentially have the same issue being reassessed twice during this period, because you have implemented for a number of years the same transfer pricing policy. The tax authorities initiate a tax audit, reassess a given period, but the policy has not been changed for the subsequent fiscal years and because of the statute of limitation, they need to reassess the first period, collect taxes and initiate a subsequent tax audit for the following fiscal years and do exactly the same thing. Technically speaking, we're talking about the same issue, but because of procedural rules, the tax authorities were bound in a way to segregate their audit into two, and lead to two reassessments leading to two collections of taxes with 40% penalties or for wilful misconduct, and basically trigger the transfer of the case to the public prosecutor. You may know that in Italy, typically to take an example, when an Italian taxpayer complies with its transfer pricing documentation, the tax authorities can always challenge the merits of the transfer pricing documentation, but since you're complying with something which has been published, which has been revealed to the tax authorities, this constitutes an exception to the criminal procedures that do exist in Italy. We do not have any such exception for transfer pricing, which of course is a major area of concern for us.
Zoe Andrews	Charles, how does the UK deal with this?
Charles Osborne	Yeah, it's very different from the UK position. We do have criminal exposure for transfer pricing related matters, but only in very limited circumstances, probably much closer to the first example that Julien was describing whereby the taxpayer has engaged in fraudulent behaviour. For us, the tax authority in the UK do recognise that transfer pricing is an art, not a science, and that there's a range of views that you can take. So simply because a taxpayer hasn't concluded their transfer pricing arrangements in line with what an audit later confirms doesn't necessarily mean that they have been fraudulent in any way, so that there is recognition of this in the UK and we don't have this same problem. Which is why

	the criminalisation of this in France is such a concern to many taxpayers who aren't used to dealing with the French system.
Julien Gayral	Absolutely.
Zoe Andrews	Julien, can you give us some examples of the issues the French Tax Authority focus on in transfer pricing challenges?
Julien Gayral	I think you could potentially summarise two, I would say two, areas of concern. First of which being the cases where the tax authorities are going to challenge the taxable basis per se of an existing French taxpayer, whether a subsidiary or an existing French permanent establishment of a foreign company. And here what we're seeing a lot is that the tax authority could quite naturally challenge the appropriateness of the transfer pricing benchmark, which is being used by the taxpayer, for instance. They could also more globally consider, and this is an increasing tendency, consider that the transfer pricing and methodology which has been used is not the proper one. And we also see, especially for multinational groups a tendency to try and defend the idea that the French contribution, has in some way either increased or led to the creation of a French intangible that needs to be remunerated one way or the other, and that the functions in France are not routine functions, but in a way contribute to the overall value of the group. We have other cases which are by the way, the ones which are even more exposed for us, because of applicable laws in France, to a potential criminal escalation, where the tax authorities are going to try to characterise a French presence which was not revealed and this can take the form either of characterising because of activities in France, a permanent establishment of a foreign entity. Or even more, characterise the effective place of management in France of a foreign company, and these are typically cases where the criminal exposure is very high, not only because of the new rules that were referenced, but precisely because of existing rules, which is that you would be deemed not to have revealed your French presence and which is a case of fraud basically. And you may know, and I think this exists of course in all jurisdictions, but we do have a tool available to the tax authorities, which is a dawn raid, the ability to make dawn raids to try and capture information, and we do have an increasing use of such dawn raids in France.
Zoe Andrews	Can you give any examples of situations where the French tax authority has used dawn raids or sought administrative assistance to get another tax authority to conduct a dawn raid?
Julien Gayral	Yes, a recent example of a foreign subsidiary of a French group deemed to operate business from a European country, benefiting from a privileged tax regime, so basically qualifying as such as per French CFC rules, because it's not suffering sufficient taxes or it's suffering taxes which are lower than the ones which have been suffered in France, and the tax authorities have initiated a tax audit of the French parent, initially understood when looking at the transfer pricing

	methodology which was applied between the French parent and the foreign subsidiary that there were functions highly remunerated in France and started by such digging into the functional profile of the foreign subsidiary which was deemed to have an operating business, and ultimately launched an exchange of information, some administrative assistance, and captured more and more elements which led them to consider that, in fact, the operations run by this foreign subsidiary were *de facto* monitored from France, so there was definitely a presence outside of France for the ongoing operation. In their mind, this was more looking at the routine function, so there was definitely a taxable basis which ought to be located abroad because of a freedom of establishment principle, but that the strategic impulse of all the activities was in fact in France, and this is precisely the criterion of the basis on which they considered that instead of leaving 100 outside of France, they should capture 100 and leave something outside of France being nothing else but the remuneration of a routine functions. This is an example we're currently facing.
Charles Osborne	And Julien, why in that situation was a dawn raid deemed required by the tax authority? Why couldn't they just ask for information on a cooperative basis, which would be the situation we would normally face in the UK?
Julien Gayral	Well, because it's making a lot of money, et cetera, and that this was a reason for which they were not that sympathetic from the outset, for what they were doing, and that it was a query, in light of the interaction with the French parent, perhaps some kind of a frustration in the way the information was shared with them. I guess they were perhaps starting to feel some kind of a resistance in trying to better understand the economic profile of the group. And I think that this is typically the situation where dawn raids could be triggered, of course, when it's at the initiative of the French sector, for it is, is in the context of a tax audit.
Charles Osborne	Yep. So it's not typically at the outset of an investigation, it's when things start to stall or they feel some resistance. That makes sense.
Julien Gayral	They want to have access to raw information. They basically they feel that this information is being digested in a way which is not satisfactory, so they want to have the raw material and get their own feeling about that. I was talking about dawn raids having been provoked by the tax authorities, but we do have a French landscape which can favour dawn raids in other circumstances and we see other factors kicking in in the context of tax audit, triggering that kind of situation, which is, for instance, when a tax issue is being raised by media or by Parliament or by whistleblowing or by the unions and this is another route. This can give rise to criminal investigation, but you can also have dawn raids being provoked by, for instance, Parliament have been hearing about a specific issue which is in the newspapers or that unions have been complaining about the tax policy of a given group in France, which is a typical way to provoke issues, by the way, because you may know that in France, we have profit sharing which is aimed at offering employees a portion of the profits. This is a mandatory

	scheme, and of course this ties to the taxable result of the group because employees are deemed to be able to benefit from a portion of the taxable profit of the company. You can reasonably imagine that when the transfer pricing policy in the union's mind, reduces this taxable basis, the appetite of the union to complain about that is high, so they can potentially complain officially about it. Try to liaise with the criminal prosecutor or make some noise about it, and once noise has been made about such an issue in the newspaper or is on the public domain it's always a bit difficult for either the criminal authorities or the tax authorities to resist the obligation to do something about it, and sometimes you can have also in this context some dawn raids being initiated.
Charles Osborne	So if we just take it back now to what lots of people will be concerned about having heard what you said, the types of criminal sanctions that could be imposed on taxpayers in the context of large corporates, what are the kind of sanctions that that can be imposed at the end of an inquiry or at the end of an audit when someone has been found guilty effectively of a criminal offence?
Julien Gayral	The pressure which is being exercised can be, is not to be ignored, because once criminal investigations are being initiated, of course the tools at the disposal of the public prosecutor are quite extensive: dawn raids, of course, but interviews, potential pressure on the individual team to have been involved in the so-called tax scheme or alleged tax fraud. So of course, before talking about any sanctions, the environment, is pretty hard to go through. Fines are pretty important because, depending on the way things are being settled, either you're convicted with tax fraud and you can have fines going basically from three million to potentially a multiple of this three million if you are in the cases of aggravated tax fraud, but the most frequent situation is where precisely because of the pressure that represents, the group will try to kind of find a settlement on that kind of cases, settlements which will lead to, putting aside the tax assessment per se, a deal with the public prosecutor, which is a way to have a fine which can be a multiple of the alleged tax fraud which can go up to 2.5 in certain circumstances. But the difficulty about it is to determine the basis of it, because the tendency of the public prosecutor will presumably be to try and extend the basis which is being used to assess the fine, and the fine will be coupled with the tax reassessments. Potential imprisonment does exist in certain instances, but we have not seen so far that kind of sanction applied to corporate officers or tax directors in the context of transfer pricing audits. Severe fines being applied in transfer pricing cases, the answer is definitely yes, and you may have heard of two public cases in France, which were the Google cases or the MacDonald cases, which led to imposing on the groups very important fines, which were calculated because of the specific frame within which this was negotiated as a multiple of the tax reassessment.
Zoe Andrews	Do you think the risk of criminalisation of transfer pricing matters in France is likely to decrease in the near future or is this here to stay now?

Julien Gayral	It's definitely here to stay and in some way, I would say it's even in front of us or ahead of us because this very specific rule of automatic referral to the public prosecutor was introduced in 2018. So, we are now facing more and more cases where the threat of a possible transfer to the public prosecutor is now on the table. So, it's definitely not going to disappear. It's definitely in front of us.
Charles Osborne	So, it sounds like the best course of action for taxpayers is to avoid getting into a transfer pricing dispute in the first place. With that in mind, what advice would you give to taxpayers operating in France to minimise transfer pricing related risks?
Julien Gayral	You have a lot of ways to deal with that kind of situation. Of course, to be very cautious about and revisit the overall structure and try to of course run it by experts to make sure that the transfer pricing policy is defendable by making to the extent relevant some economic analysis by a third party just to strengthen their position. Rethink their organisational metric and make sure that the remuneration is being properly allocated and here again the advice of economic experts is of essence. You do have tools which are very important, of course: agreements with foreign tax authorities, whether unilateral, bilateral agreements or trying to negotiate some APAs with foreign tax authorities between tax authorities to try and secure the transfer pricing policy. This is definitely something which is being increased over time. In parallel to the Anti-Fraud law France has introduced a quite efficient tax partnership agreement, which is basically a way to have a prior discussion with the tax authority on selected tax matters, which is a way to secure the position outside the context of the tax audit and get rulings, of course, in that context, ahead of any potential investigation from the tax authorities and this has been quite a success in France. We now have around 80 groups and by eighty groups it covers, of course, all the entities concerned by these groups. It has proven to be quite efficient, because precisely this has been seen as a very good way to collaborate with the tax authorities in advance and raise any potential concerns these groups have to try and find amicable solutions or prior rulings to secure positions.
Charles Osborne	And are there restrictions on who can enter that partnership? Is there a size limit or anything else that people need to bear in mind?
Julien Gayral	Well the size limit, you have minimal size, but given the people we're talking to, usually multinational groups, they check this box. One thing which is important is that you will be forbidden to enter this programme, and we're back to square one, if you have suffered wilful misconduct penalties over the preceding fiscal years. Something which is also important without entering into the partnership agreement is another section which has been created, which is part of the same department within the tax authorities which is a regularisation desk, to put it literally, which is not per se a partnership agreement, but which is a way to spontaneously regularise a situation that you've identified that you don't feel comfortable with, which could be, for instance, the case in the context of an M&A

	transaction where you happen to identify something within the groups you've just purchased and that you don't want to live with. You have the ability to liaise with the tax authorities on a spontaneous basis, to discuss the issue. The discussion will not be as to the merits of the case. If you start discussing with this department, you will acknowledge that you want to regularise something. They're not going to do an assessment as to whether or not you're coming from good reasons. The good thing about it is that you will be able to settle the situation with reduced penalties, but the penalties on a reduced rate, which will be applicable in that context, will not give rise to a transfer to the public prosecutor because they are not the consequence of a tax audit, they are the consequence of a spontaneous request you made to the tax authorities, and I think this is of relevance for especially in an M&A context where sometimes you happen to discover something that you would like to make disappear.
Charles Osborne	Taking all of these things together, it feels very much like there is a push to get taxpayers to settle, to be open and then settle disputes before they become genuine disputes.
Julien Gayral	Absolutely.
Charles Osborne	In particular, around that 40% penalty regime and the consequences if you do get one of those penalties levied.
Julien Gayral	Absolutely, absolutely. So, we can of course not accuse in any way the tax authorities to leverage on this, because this would not be a proper way to put things, but definitely the tax authorities do have in mind a threat it represents and know that the taxpayers will presumably have an appetite to find tax settlements in an intelligent way.
Zoe Andrews	That seems a good point to end on. I've really enjoyed our discussion in France, which is the last stop in our tax disputes series. Thanks to Julien and Charles for joining me today to share their expertise and experience in this area. And thank you for listening. If you have missed any of the earlier episodes in this series, you can find them under Slaughter and May's Tax News podcast or our Horizon Scanning show. For more insights from Slaughter and May's tax department, please go to the European Tax Blog, www.europeantax.blog, or follow us on Twitter, @SlaughterMayTax. Or just drop us an email.