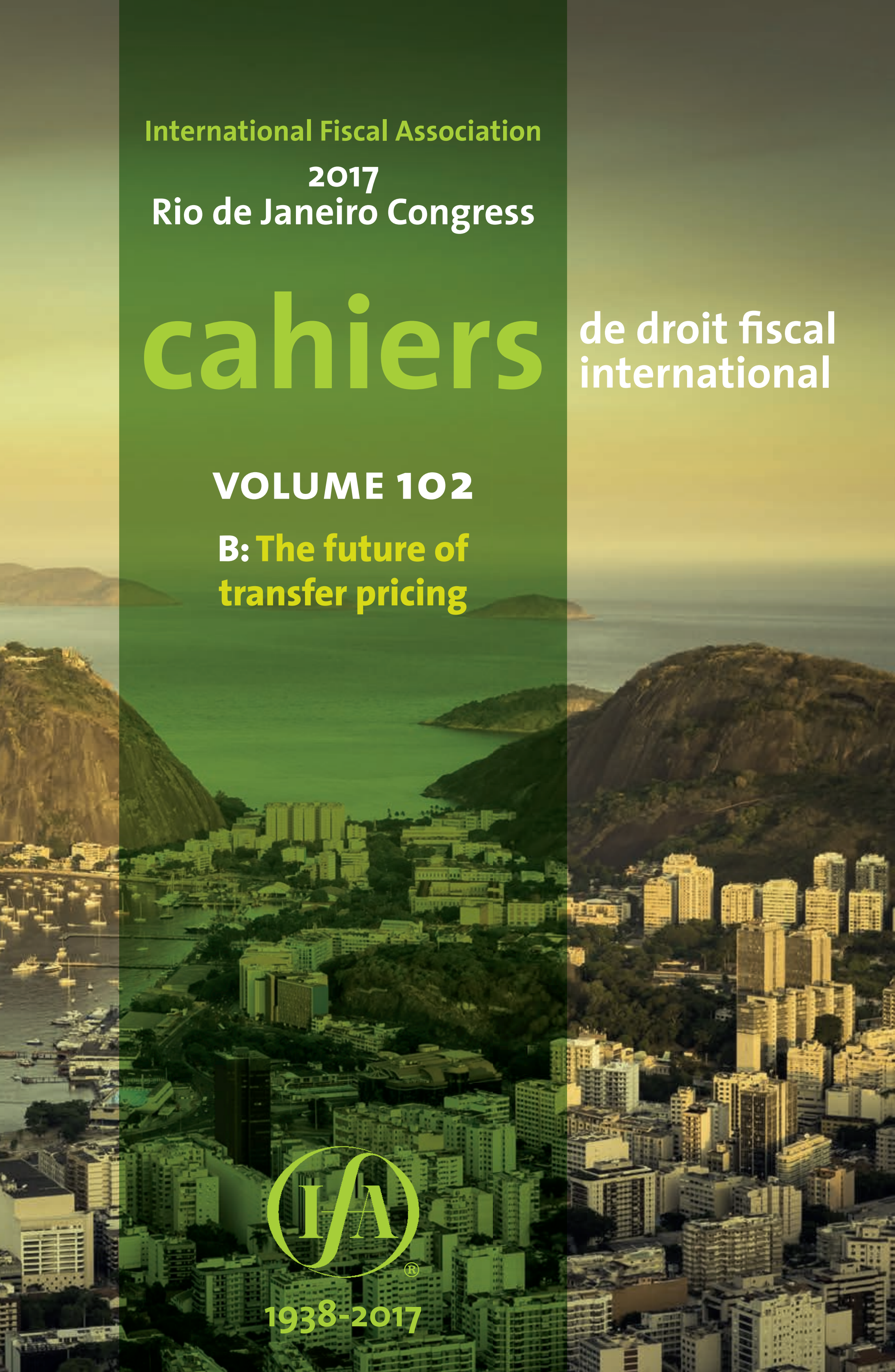

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B: The future of transfer pricing

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Summary and conclusions

Transfer pricing (TP) has been a real matter of interest in France since the beginning of the 1990s, for both taxpayers and the tax administration. In this context, the OECD works on base erosion and profit shifting (BEPS) have been seen in France as a really important contribution. In fact France has been one of the countries most involved in those BEPS works and the public reports were welcomed at the end of 2015 by the government and tax administration. Taxpayers are generally speaking more suspicious about the real consequences of the implementation of the BEPS recommendations.

A TP regulation has been in place for a long time in France, even though no detailed explanations have been provided, unlike in some Anglo-Saxon countries. This explains why both taxpayers and the tax administration directly refer to OECD principles and commentaries. Broadly speaking, the French tax administration (FTA) pays specific attention to TP as it is one of the main interests of the tax audit department.

However, France has always been keen to enforce the arm's length principle and to respect the choices of multinational companies (MNEs) in their organization, in order to allow international groups to establish themselves in France and to carry out their activities there. Nevertheless, the FTA is ready to contest abusive schemes and fight tax fraud. That is the reason why it broadly favours the BEPS recommendations. On the other hand, taxpayers have expressed concerns about the way those recommendations may be enforced by the FTA and are waiting for clarifications and explanations, in order to be able to comply and have legal security.

One of the specific challenges in France is connected to transactions with intangibles. As there is no detailed definition of an intangible in the French law, either in accounting law or tax law, both tax administration and taxpayers are doing their best to align with OECD principles; but it is not certain that the latest BEPS explanations will be sufficient to clarify the matter, even though a large number of the BEPS recommendations have already been implemented by French tax auditors.

The FTA has been fighting against business restructuring for some years now and it does not hesitate to use its abuse of law procedure to challenge some con-

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tracts or organizational schemes of MNEs if the legal structure of the group and the contracts provided do not match with reality. The French approach is in line with the "substance-over-form" position of the BEPS reports, even though it is based on an exclusive purpose test, and not a principal purpose test.

French tax auditors have sound experience with comparability and group synergies. Even though there is no specific regulation or domestic guidance, they apply consistent argumentation. In fact Actions 8–10 of the BEPS report are in line with recent tax cases.

Looking at "hard-to-value intangibles", the BEPS recommendations may lead to a change in the tax auditors' position. The *ex post* evidence as described in the OECD report may be seen as a possibility for tax auditors to adjust past profits or losses on the basis of the real situation as currently known, even if that real situation could not possibly have been anticipated at the time of the entry into force of agreements or operations.

The FTA has always been concerned by financial interests and still is. However, tax auditors' practices are in line with BEPS recommendations and they have for a long time been using some of the criteria suggested by the OECD, even though the latter are more detailed. However, there is no indication that the French tax law will soon be modified to include them.

The French approach to intra-group services is connected to reality, looking at the contract, at evidence that the services are really provided and that the evaluation method for the fees is appropriate and correctly implemented. There is no general refusal of those intra-group services and France could easily endorse the OECD simplified mechanism; however, no move can be anticipated for now from the FTA.

The French position on profit split is gradually evolving, as one can see that tax auditors generally accept the use of that method more easily, even though this is more as a double check method than an initial one. However, they will accept its use as a first rank method, if it is implemented by a group; tax auditors would then be really thorough during audit investigations.

The country-by-country reporting (CbCR) requirement is now part of French tax law and France has mentioned that it will soon be part of the process of exchanging information with treaty partners. The debate is actually focusing on a possible public CbCR now and the situation may evolve very quickly in the coming months. As the BEPS recommendations are adding some specificity to the master file which are not included in domestic tax law, one could anticipate an addition of these specifics at some point; however, nothing is planned for now.

From a French perspective, one could consider that the BEPS recommendations might provide more security to MNEs, by detailing rules and bringing guidance to taxpayers. This benefit may also come from OECD proposals regarding limits to intangible comparisons, the optional approach of limited value-added services and an improvement in advance pricing agreement (APA) and mutual agreement (MAP) procedures.

Looking to the future, a generally accepted approach is to anticipate a shake-up in the area of TP, as the BEPS recommendations will probably lead to more pressure on business, starting with a requirement for more transparency, including public information, more severe penalties and less amicable discussions with tax audit services. Beyond this technical evolution, three major changes may be foreseen in

France, with (a) the profit split being accepted as a more common method, (b) a possible change in the field of TP coming from the introduction of the CCTB in Europe and (c) TP aspects entering into the public sphere of concern, outside the usual tax specialist fora.

1. Introduction

TP has been a real matter of concern in France, for both the tax administration and taxpayers, since the beginning of the 1990s. At that time, tax auditors started to delve deeply into the details of the TP policy of MNEs, the amounts at stake started to increase and international groups started to develop their international organizations to better fit their markets and their operational needs.

Since then, interest in TP has been constantly growing. This has led to an increase in the resources devoted to it by the FTA, both in the number of tax auditors able to manage this specific kind of audit and in the quality of these tax auditors, increasing the number of specialists in this area and also the training of general tax auditors able to deal with this specific aspect of international tax. Taxpayers also have considerably increased their knowledge of this matter, developing sophisticated TP policies, increasing their skills and expanding the number of TP specialists embedded in their tax teams.

Moreover, after a period during the mid-2000s when TP was considered as "under control", or at least manageable, the FTA and taxpayers were conscious of the specific aspects of this sensitive part of taxation, but aware of the technicalities of working with and managing them, a new era came when, in the mid-2010s, TP was suddenly seen as a specific tool used by MNEs to drive their profitability in France (a high corporate tax rate country compared to some other OECD countries). A common feeling started to develop of seeing TP policy as fraudulent behaviour used by taxpayers to pilot the location of their profits, in the wake of (a) various leaks, (b) concerns about the business restructuring of several international groups, and (c) several attacks against various GAFA. This was obvious when, at the end of 2013, Parliament voted for the end of tax collection suspension during an MAP (Finance Law for 2014) and the expression "tax fraud" was explicitly mentioned during the parliamentary debates on this specific aspect of TP.

In this context, the OECD works on BEPS have been seen in France as a really important issue, specifically in the TP area, and particular attention has been paid to the expected outcomes. These were seen as possible solutions to limit abuses and provide help to deal with specific and difficult situations.

Before reading the following report, it should be recalled that France has been one of the leading countries in those BEPS works and that the French tax community (whether the FTA or the private sector) has been willing to be very much involved in the process, and saw itself as one of the major contributors. This partly explains the favourable perception in France of the BEPS recommendations, the commentaries expressed to welcome them and reactions to the future of TP in France.

It should also be noted that, at the time this report was written, France had implemented the CbCR and the provision for an exchange of information with its treaty partners. Works have been completed during summer 2016 at the European Union (EU) level to finalize the Anti-Tax Avoidance Directive, and France will in fact implement its own set of measures and take into account the EU rules.

2. Current TP regulation and practice in France

The TP concept was introduced in France by article 57 of the Tax Law in 1933. The words "transfer pricing" are not used but this article explicitly refers to "direct or indirect transfer of profits" by a company under the dependence of a foreign company or controlling a foreign company. This single article of the French tax law is actually the only one to be used by tax auditors to adjust the price of international transactions between companies of the same group.

The wording of this article is largely in line with article 9(1) of the OECD model and is fully aligned with the principles underlying this article. Knowing that French tax conventions are broadly in line with the OECD model, there is usually no conflict between treaties and the domestic rule.

To challenge the TP policy in place in a group or the price of a specific transaction, the FTA should be able to gather facts showing that two cumulative conditions are met: (a) a real dependence between the French company and the foreign entity concerned in the transactions at stake; (b) a real advantage (the transfer of profits) provided by the French company to the foreign entity.

The FTA has provided general guidance to help taxpayers and tax auditors to implement this article (BOI-BIC-BASE-80-10-10-20140218 and 80-10-20-20160203). This is much less developed than what can be found in some other countries. It is often seen as a matter of concern by taxpayers, mostly by foreign groups, that no specific and detailed directions or advice are provided. However, it can also be seen as positive, as the FTA may not challenge the group implementation of its TP policy as long as the group is able to detail it and provide solid consistent explanations.

Interestingly, specific developed guidance has been provided (in 2006) by the FTA to help small and medium-sized groups to expand their international development. A summary of the main OECD principles and basic landmarks are highlighted to facilitate the understanding of TP by this group of taxpayers and guide them (TP methods, use of comparable companies, the possibility of asking for an APA and a specific procedure dedicated to small and medium-sized enterprises).

In this context, it is quite logical that the FTA and taxpayers directly refer to OECD principles and commentaries to substantiate their positions.

If this article of the French tax law has been stable, various tools have been developed over time to help tax auditors to really challenge the TP policy of a group. These articles of the French tax law have provided them with more time to ask the French treaty partners for information, to access more information and figures after the beginning of the tax audit, and even before the tax audit starts.

To focus on the main possibilities offered to tax auditors, it is interesting to make a distinction between (a) the initial move, which is intended to help the FTA during the audit procedure, and (b) a recent second step, which leads to facilitating risk assessment and the work on the file, from the office, in order to target international tax audits.

The initial move was made in 1996, when article L.188A allowed for an extended period of possible tax reassessment (two further years) when information was requested from a treaty partner. It was complemented more recently by article L.13AA of the French Tax Procedure Law, which in 2009 introduced the European Union Joint Transfer Pricing Forum (JTPF) recommendations regarding the master file and the entity file, to be mandatorily provided to the tax auditors from the very beginning of the tax audit.

The second step was initiated in 2015 with the introduction of article 223 *quinquies* B of the French Tax Law, creating a mandatory report of the main information relating to the intra-group transactions, to be electronically filed with the FTA.

Broadly speaking, the FTA pays specific attention to international tax aspects, and specifically to TP as this is one of the main matters of interest of the Tax Audit Department and one of the key drivers of FTA audit activity. At the same time, the double taxation which arises from these TP audits is a major source of concern for international groups as the duration of an MAP is slowly decreasing but there is no longer any tax collection suspension during the course of this procedure.

3. The impact of the BEPS project on TP in France

3.1. Introduction

As mentioned above, the BEPS TP recommendations were seen as an important outcome of the BEPS works. France has been one of the active contributors and the French private sector has been vigorous during the public consultation process.

The authorities in France warmly welcomed the BEPS reports at the end of 2015. The French Minister of Finance strongly supported the BEPS recommendations, seeing in the reports a major effort in the fight against MNE tax erosion. He also encouraged a European common action to implement part of these recommendations on a coordinated basis.

This evident French support for the BEPS recommendations has peaked with the early introduction of CbCR into French tax law at the end of 2015, under article 223 *quinquies* C of the French Tax Law, a few weeks after the BEPS reports were made public, with wide support from the French Parliament (CbCR is mandatory for fiscal years starting on and after 1 January 2016). Moreover, France has been one of the first countries to sign the Multilateral Competent Authority Agreement on the exchange of CbCR (France signed on 27 January 2016). Another example of this active support has arisen from the question of public CbCR, which was taken up at the end of 2015 and has been constant since then.

The FTA has not publicly commented in detail on the BEPS reports. There is no doubt that it broadly favours the implementation of the recommendations. However, one could assume that some recommendations may not be totally in line with the initial and ideal wishes of the FTA. For example, France was keen in a specific action dedicated to internet activity (works are still to come on this aspect under Action 1). Another is related to business restructuring, where France has been actively promoting stringent measures to help contest this type of MNE reorganization, even though BEPS provides some useful tools.

The private sector approach consisted, in a nutshell, in a fear of an unfair implementation of the BEPS recommendations by tax auditors, knowing that changes brought by the OECD reports were major and that groups would have to adapt in the context of limited guidance. Moreover, it was clear that anticipation of the domestic implementation of these new rules would be difficult (and still is), despite the fact that the OECD was providing a relatively weak insurance by improving and strengthening the elimination of double taxation. Representatives of the financial sector and insurance companies were worried about the fact that those recommendations did not provide guidance specifically applicable to these two particular sectors. One of their concerns was that examples are irrelevant for companies in those industries and that, in dealing with risks, the specificities of these activities are not addressed. They also highlighted that some OECD suggestions have already been implemented, and that concepts and proposals have already been taken into account.

3.2. Challenges of transactions with intangibles

3.2.1. Definition of intangibles

The qualification of an intangible has always been a question of specific interest in France, as intangibles are commonly recognized as the main driver of the value creation and, consequently, of the remuneration level to be allocated to their owner.

Quite recently, starting in the mid-2000s, it has also been a major question for tax administrations in general and the FTA in particular, as groups have started to reorganize their activities, opening some interrogations about so-called "business restructuring", which usually leads to relocating not only some intangibles, recognized as such, but also part of the activities, functions and risks, which may, alone in combination, be considered at some point as intangibles.

As long as France only had a limited specific domestic set of regulations, particularly looking at intangibles, there was no definitive clear public guidance provided by the FTA. Intensive domestic works were carried out during the OECD works leading to the July 2013 report on intangibles. In line with the OECD works at that time, the main question was to consider whether or not the definition of intangibles should stick to the legal definition (mainly, assets that can be accounted in an entity's books). As a Latin law country, this was the most obvious answer for France. However, that answer could not capture specific circumstances such as business restructuring, where no accounting asset may be moved from one entity to another.

This situation has led the FTA to try to amend article 57 of the Tax Law (see above): in the case of business restructuring, meaning the transfer of intangibles, functions and risks, the article would have created a presumption of transfer of profits, and the French entity would have faced the burden of proving that no benefit had been transferred (and not the tax administration, as provided under the article 57 provisions). However, the *Conseil Constitutionnel* (the High Administrative Court responsible for ensuring that the law conforms to the Constitution) rejected the draft article as the intangibles, functions and risks supposed to be transferred are not defined in tax law.

Of course, like other tax administrations, French tax auditors have also faced problems in dealing with specific situations where "marketing intangibles" may be developed by an entity, or when unique intangibles and high-value intangibles were at stake (such as intra-group synergies, specific economies arising from a single procurement for the whole group, unique management of the logistic chain, etc.).

In fact, there is no specific tax definition in France. Article 38 *quater* of Annex III of the Tax Law refers to the French general accounting rules. The FTA regulations detail the criteria of the accounting rules, which mention in their article 211-5 that an intangible is a "non-monetary asset without any physical substance". This asset should meet one of the following alternative conditions:

- be separable from the activity of the owning entity, meaning that it can be sold, transferred, leased; or
- be protected by a legal or contractual right (like a patent or a commercial property).

According to the FTA regulations (BOI-BIC-CHG-20-10-10-20141013), an intangible should also be the source of future profits and be usable for a long time (at least more than one fiscal year). This definition is applicable to all kinds of intangible types, whether bought from another entity or internally created.

Those criteria are commonly used by the judge and consistent jurisprudence has drawn a clear line to identify intangibles.

However, the BEPS Actions 8–10 report has changed the OECD TP guidelines under chapter VI, introducing clarifications, particularly on the fact that intangibles are not always recognized as intangible assets for accounting purposes. Similarly, the report states that whether an item should be considered to be an intangible for TP purposes, under article 9 of the OECD model, can be informed by its characterization for accounting purposes, but will not be determined by this characterization alone.

Despite this attempt at clarification, it is not certain that this new OECD guidance will be sufficient to provide an easy recognition of intangibles. Nevertheless, this OECD clarification may need a particular French tax rules modification to include these specificities in the body of French law and regulations. However, tax auditor practices have already tried to include such an approach in some of their tax adjustments.

3.2.2. Transactions with intangibles

As mentioned above, the FTA has been active on this aspect of intangibles. More generally speaking, French tax audits have been driven by a concern for international operations and the fight against tax avoidance. To work in that direction, specific attention has been paid to operations with high amounts at stake, specifically in transactions regarding high-value intangibles, and audit services have tried to challenge MNE organization and intangible transactions with tentative new approaches.

In some ways, even though the OECD has provided clarification with more details and explanations, it could be considered that the FTA was already implementing some of the BEPS recommendations in this area. That is the situation regarding the way in which groups use an intangible.

French tax auditors are usually very careful about the way several entities of the same group deal with an intangible. They would typically ask questions about investment in the maintenance of the intangible, the actions performed by the supposed intangible owner to defend its legal right to this intangible and to fight against counterfeiting, etc. This information will then drive the allocation of the remuneration, depending on the level of an entity's involvement in these various functions.

Even though the so-called DEMPE functions (development, enhancement, maintenance, protection and exploitation of intangibles) are not mentioned by tax auditors and are clearly not mentioned in the FTA regulations, the approach is identical to that now suggested by the OECD in the new chapter VI of the guidelines. These DEMPE criteria will certainly now be used by tax auditors, who may set a specific list of questions to taxpayers when looking at transactions on intangibles. However, this may not lead to a revolution in the general approach of the FTA.

Even though there is no need in France for an introduction of these new criteria to identify the functions and valuate the remuneration, it will be interesting to see whether the FTA will take the opportunity of this specific BEPS recommendation to develop and give details of its TP regulation on this matter.

What may be considered in France as a brand new approach in the BEPS recommendation in this area is the new place allocated to the *ex post* outcomes as presumptive evidence about the appropriateness of *ex ante* pricing arrangements. French tax auditors were already looking to the actual results of the transactions, to gather a sense of what had been done by MNEs and to see whether what was originally planned was genuine. However, until now, this has been more of an indicator or an initial step of a risk analysis, but it has not been used as the main element of a tax reassessment.

The new wording of the chapter VI principles will probably lead the French tax audit services to adopt this approach, which is expressly presented as a way to provide comfort to tax administrations, given information asymmetries. Even though the BEPS report on Actions 8–10 states that further guidance will be drafted during 2016, it may be anticipated that this *ex post* check will be implemented in audits, even before this guidance is provided. The FTA may also want to include some specific comments or details in the domestic regulations.

3.2.3. "Substance-over-form" approach towards intangibles

This method of taking an *ex post* look at transactions could be seen as similar to the substance-over-form approach included by the OECD within the new chapter VI of the OECD TP guidelines. It offers a possibility for tax administrations to challenge the organization and the prices presented by MNEs, based on contracts and what is often described as their internal operational organization.

This possibility exists in France and is used by the FTA. It allows tax auditors not to stick with the presentation provided by taxpayers or in contracts, but to try to demonstrate that the reality, whether operational or economic, is different. This demonstration is subject to judicial validation.

The *abus de droit* (abuse of law) allows tax auditors to contest the outcome of a contract or any other legal agreement between parties when they are able to demonstrate that this contract was only designed to bypass a law for the sole purpose of avoiding tax.

Article L.64 of the Tax Procedure Code mentions that, when determining taxable income, the tax administration can reject any contracts, organizations or transactions, whether they are (a) fictive or (b) only seeking an incorrect implementation of the law, to take into account the reality of the activity.

The FTA regulation (BOI-CF-IOR-30-20140124) details the difference between these two branches of this procedure. Looking at fictive operations, it specifically mentions that this is designed to contest situations where there is a discrepancy between the contract or/and the transaction on the one hand, and the economic reality on the other. Examples include a situation where a taxpayer is setting up an artificial legal and economic organization.

This procedure is dedicated to fighting against severe tax evasion schemes and is complemented by penalties, depending on the taxpayer activity and its implication in the design of the scheme. Article 792 *bis* of the French Tax Code states that those penalties could be 40 per cent or 80 per cent of the tax adjustment.

Tax auditors have to perform in-depth investigations, and collect information and facts to substantiate their position. They will have to detail the rationale of this abuse of law to a tax judge in charge of the validation of the tax administration position.

This procedure is commonly used by tax auditors (even though the number of abuse of law cases is commonly quite low). It provides the FTA with a real possibility to contest the alleged operations and organizations of taxpayers.

The OECD has provided clarifications in the recommendations on Actions 8–10 of the BEPS report regarding intangibles. However, OECD TP guidelines have already included the possibility for tax administrations to contest the initial presentation of transactions by MNEs. Paragraph 1.64 of section D.2, Recognition of the actual transactions undertaken, states that a tax administration’s examination of a controlled transaction may, in exceptional cases, disregard the actual transactions or substitute other transactions. This was part of chapter I dedicated to the arm’s length principle and so is of general application, including transactions on intangibles.

The BEPS report provides a new version of chapter VI dedicated to intangibles. Paragraph B.1 explicitly states that contracts are a starting point of the analysis of a transaction but should be completed by a careful examination of facts and the parties’ behaviour. It also refers to paragraph D.1.1 of the new chapter I, which explains the way to better apprehend the real functions performed by each of the parties.

The French legal approach is commonly based on contracts and official documents settled between the parties. However, as described above, the FTA benefits from specific tools designed to allow for a detailed scrutiny of real transactions, in order to depart from the contract and eventually work on the basis of the substance of the transactions.

Moreover, this approach has been strengthened by the validation in July 2016 of the EU directive dedicated to measures against tax avoidance, which will enter into force on 1 January 2019. This directive, partly worded to organize a consistent implementation of the BEPS recommendations within EU Member States, includes a general anti-abuse rule leading Member States to ignore arrangements when they are not genuine and defeat the object or purpose of the applicable tax law.

Although the French approach is already in line with such provisions, it will differ, as the directive targets arrangements when they are in place "for the main purpose or one of the main purposes of obtaining a tax advantage". Article L.64 of the Tax Procedure Code explicitly mentions that an abuse of law is constituted when arrangements are exclusively devoted to gaining a tax advantage. Of course, it will be much more difficult for MNEs to explain that their arrangements did not include a tax advantage as one of their main purposes than to explain that this was not the exclusive goal of entering into those arrangements.

While the new chapter VI will provide room for more discussion and work for French tax auditors, one could anticipate that it will not dramatically change the way they perform their investigations, even though they may pay more attention to specific transactions. No change in the French law may be anticipated on this aspect. However, from a general point of view, it will be interesting to see how French tax law will be adapted to take into account the EU implementation of such a general anti-abuse rule.

3.2.4. Comparability and group synergies

French tax auditors have been active in the analysis of the integration of entities within a group, and the benefit the whole group may be able to gain from such integration. Once again, there is no specific law or tax administration regulation connected to this approach. However, tax auditors have developed a common understanding and are able to apply consistent argumentation.

One of the main examples provided by Actions 8–10 of the BEPS report is well known by the French tax auditors, whether it is within chapter VI, dedicated to intangibles, or within chapter I, devoted to arm's length principles (and examples 3 to 5 under section D.8, MNE group synergies). The actions of a shared services company involved in purchases for the entire group is one of the most obvious examples of group synergy.

The FTA has for several years been developing a position leading to an attempt to evaluate the share of the benefit coming from this group action to be allocated to the single French entity as one which allows the group to be able to use its size in the negotiation with its suppliers.

On this specific matter, the French tax audit services will probably not have to adapt to new rules or new principles. In fact, the BEPS recommended approach has already been designated in France for several years now. Roughly speaking, tax audit services share the group synergies arising from the combined purchasing power between entities mostly using the turnover of each of them.

The new BEPS recommendations may lead the FTA to issue new regulations to develop its approach towards this specific type of synergy, in order to detail it and provide tax auditors and taxpayers with precise directions. It may also take the opportunity of this new regulation to expand the scope of its consideration for this specific group benefit.

The financial side of the BEPS recommendations (see examples 1 and 2 under section D.8 of the new chapter I) has been a difficult aspect for tax auditors to take into account. The issue has been seen and explored for a long time now, but ways of dealing with it may have changed over time, depending on an MNE's organization and financial operations. In fact, the guidance provided by Actions 8–10 of the BEPS report is in line with recent case law: the judge is ready to take into account the benefit provided by the group, by the decrease in the rate of a loan for example, as long as there is a positive action of the mother company of that group, i.e. when it agrees to guarantee the loan.

Once again, one may anticipate that the FTA may want to internally adapt some of the OECD recommendations, in order to provide guidance to tax auditors and taxpayers. However, this would not lead to a change in the French tax law.

Paragraph 6.30 of the new chapter VI explicitly mentions that such group synergies cannot lead to an intangible creation, as they are not owned or controlled by an enterprise. The FTA has never followed that route and would contest such a demonstration if it was tentatively developed by a group.

3.2.5. Hard-to-value intangibles

The new chapter VI on intangibles provides a definition of hard-to-value intangibles. It uses two criteria: (a) that no reliable comparable exists and (b) that projections at the time of the transactions were highly uncertain, making it difficult to predict the level of success of the intangible. The FTA has not provided such a definition for these specific types of intangible and nothing in its regulations is specifically designed to deal with them.

However, transactions on these hard-to-value intangibles have been a matter of concern to tax audit services for a long time. They are trying to take into account references helping them to find comparability with other intangibles or similar situations and functions. Valuation often leads to long discussions with taxpayers on the criteria to take into account and figures to be used.

The *ex post* approach is much appreciated by auditors, even if it is not always used as the only way to correct revenues allocated to the French entity but as a clue among others to come closer to what may be the real substance of the transaction and the intangible at stake.

In fact the main part of discussions between tax auditors and MNEs will be focused on the nature of the hard-to-value intangible. It will include a description of the development procedure of the intangible, in the life-science sector for example, in order to better see what this procedure is and identify the different phases of development, to weigh the potential risks to come and see whether the procedure can already be considered as an intangible and, if the answer is yes, what revenues may already be anticipated from it, knowing that the group is still bearing a high level of risk as the development may not lead to the expected outcome, due to unsuccessful fundamental research. Similar situations may arise in the development of software or brands.

This part of the work is mainly of a technical/scientific/operational nature and not directly connected to tax matters. It relies on the experience of tax auditors and the capacity of MNEs to describe their activities and provides a rationale to detail the common habits of their industry community. It clearly highlights the need for stable and experienced resources within the tax administration and the MNE's capacity to gather, keep and detail contemporaneous information to sustain its position later during possible tax audits and MAPs.

These kinds of specific transactions have sometimes been scrutinized by the FTA, on the occasion of APA requests. In such cases, the precision and the reliability of the information provided by MNEs can be decisive for the success of the request. For instance, some APA requests have been modified or could not be accepted because of uncertainties connected to the transactions, to the future activity to be developed with the intangible, or because of the nature of the intangible itself (i.e. partly developed, or still in the process of obtaining public agreement before its introduction on to the market).

As explained above, details provided by the FTA in the area of TP are quite limited. However, due to the development of the OECD guidance under the BEPS recommendations, specific advice would be helpful for taxpayers involved in some industry sectors (pharmaceutical, IT, industries relying on highly technical intangibles with a long period of development) and may be provided by the FTA, based on its experience in specific cases.

Moreover, knowing that the general French technical position regarding BEPS reports is in line with the conclusions and recommendations, there may be a specific move and public regulations provided to embed the two most important exceptions mentioned by the new chapter VI: (a) the avoidance of the *ex post* evidence approach when detailed information on the *ex ante* domestic projections is provided and when unforeseeable events explain discrepancies between financial projections and actual outcomes; and (b) the absence of adjustment when the difference between projections and outcomes leads to an increase or a decrease of the intangible compensation limited to a maximum of 20 per cent.

3.2.6. Cost contribution agreements (CCAs)

As indicated above, not much detail is provided by the FTA to provide national guidance to economic operators. CCAs are only mentioned in the FTA regulation as a way to split the costs to develop an intangible (BOI-BIC-BASE-80-10-10-20140218) but no further explanation is provided.

French tax audit services and MNEs can refer to the EU report on CCAs on services not creating intangible property. This report of the JTPF of the European Commission (finalization of works performed from July 2010 to June 2012) provides explanations to both European tax administrations and international groups with advice to reviewers about this type of CCA. The report details a list of criteria to check, in order to ensure a common understanding among EU Member States with factual recommendations.

Even though this JTPF report does not provide information connected to intangibles, as long as there is no specific information, the FTA currently relies on those principles and, knowing that CCAs are not often used by MNEs and so are not so commonly scrutinized during tax audits, one could anticipate that France will not provide further domestic guidance regarding this specific type of intra-group contract.

3.3. Risk and capital

For a long time French tax auditors have been paying a lot of attention to the questions of risk and capital attribution as revenue allocation drivers. This started when international groups implemented specific policies designed to structure their organizations differently from the way independent operators would do. By carefully attributing risk and capital to dedicated companies, they were deconstructing normal transactions, including a whole range of services, risks and capital ownership, and were creating new types of transactions which did not exist as such between third parties.

The FTA soon saw those transactions as dangerous from a tax collection perspective and it has targeted them in tax audits. However, although they were described as risks to be assessed, no specific or detailed commentaries and guidance were provided. Nevertheless, tax audit services have identified what has become the usual way of analysing the reality of those transactions and valuing them.

In fact, one can recognize in Actions 8–10 of the BEPS recommendations some of the criteria that French tax auditors are currently using, aiming either to demonstrate that such a risk/capital allocation is not real or that the pricing is inappropriate.

Tax auditors are paying attention to (a) the control of the risk (whether it is acceptable to bear it or to mitigate that risk), (b) the capacity of the risk-taker to financially face that risk, and (c) whether that risk really exists. That focus is leading to a list of questions connected to the group operational organization, the situation of the key people able to take the appropriate decisions, the careful description of the nature of the risk, the last time that risk was borne by the group, the possibility of asking for insurance coverage from a third party, etc.

However, the BEPS recommendations have either (a) detailed the steps of the process to analyse risks in a controlled transaction or (b) clearly offered the possibility of ignoring the contract and organizational description provided by groups and sticking to what is assumed to be the intention of the parties (see new section D.1.2.1 of chapter I of OECD TP guidelines, Analysis of risk in commercial or financial relations, especially paragraphs 1.60 and 1.86, the latter providing explanations on step 5 of the process).

There is no indication for now of any move from the FTA to internally introduce those comments or provide for any specific detail within the French regulations. It may be anticipated that it will not do so, as a direct reference to the OECD TP principles is possible, but tax auditors will certainly now use these precise indications during their investigations.

3.4. High-risk transactions

3.4.1. Comparable uncontrolled price (CUP) and quoted prices for cross-border commodity transactions

In this area, France does not have a specific position that deviates from the OECD TP principles. As already described above, as TP comments from the FTA are rather limited in comparison to those from some of its treaty partners, nothing specific has been published. However, those new principles introduced in the OECD TP guidelines are already enforced by the French tax audit services and will probably not lead to additional comments from the FTA.

3.4.2. Intra-group services

The FTA has always held a moderate position regarding intra-group services, in line with OECD TP principles and the EU JTPF recommendations.

In fact this position is in line with principles designated for many years by well-established domestic jurisprudence. The French judiciary has designated a clear process in three steps, leading to a validation of the deduction of those expenses: (a) are they real? (b) Are these expenses correctly priced? (c) Are these expenses useful for the paying company?

On the basis of these criteria, taxpayers can be confident that the management fees/low value-added services will be accepted by tax auditors during an audit. Moreover, and unlike some of its treaty partners, French tax auditors have adopted a reasonable standpoint when investigating under the first step of the process. Some years ago, they followed the temptation to dig into too much detail to assess the reality of the services provided and the way in which they were allocated to subsidiaries. They were asking for lots of explanations on the type of services and people involved in the activities, challenging allocation keys and asking for detailed timesheets.

This approach belongs to the past and, in the vast majority of cases, tax auditors are today more focused on the needs of the French entity and the rigorous enforcement of the policy set by the group. This pragmatic approach can be linked to the progressive implementation by the French tax audit services of the EU recommendations in that matter.

On 25 January 2011, the EU JTPF adopted a report based on the works performed by the forum between April 2009 and June 2010, including guidelines on low value-added intra-group services. In line with the OECD TP guidelines, it was in particular suggested that a 5 per cent mark-up was usually a remuneration commensurate with the effort provided by the entity in charge of regular central services and management fees.

This 5 per cent rate is mentioned in Actions 8–10 of the BEPS recommendations. However, those recommendations go a step further, providing for a simplified mechanism. Such a mechanism is expected to be in place once sufficient countries have recognized this new simplified approach. This OECD BEPS suggestion includes the possibility for tax administrations to adopt a threshold, to enable them to review the simplified approach in cases where the threshold is exceeded.

This threshold may recall the habits of some French treaty partners of not allowing the deduction of those central low value-added services for an amount exceeding some kind of arbitrary threshold (not deriving from domestic law or tax administration regulations). The FTA has never enforced such a cap, even though tax audit services of course look at the weight of such services in the audited company, paying more attention when they exceed a commonly accepted percentage.

For now, the FTA has not made any specific announcement on that OECD suggestion. However, it may be anticipated that France will accept this new initiative and endorse the domestic implementation of this simplified approach before 2018. The French Parliament or the tax administration may not take the opportunity of this endorsement to introduce a threshold, as suggested by the Actions 8–10 OECD BEPS report.

3.4.3. Profit splits in the context of value chains

The FTA regulation includes the description of the TP method recommended by the OECD (BOI-BIC-BASE-80-10-10-20140218). The profit split method is of course one of them. Although the methods were originally differentiated into preferred and subsidiary, as initially recommended by the OECD, this distinction has now disappeared and the regulation states that the most appropriate method should be selected by the group to properly remunerate the French entity, once again fully in line with recommendations provided in chapter I of the OECD TP guidelines.

However, experience shows that tax auditors may not always be keen to use the profit split method, as the way some groups implement that method may be complicated, with no detailed information about the keys they use and no clear explanation of the link between these keys and the activities performed or the profit to share.

Interestingly, even though the profit split is usually used by larger international groups, as long as this method is supposed to be connected to the use of the more integrated transactions and the highest value-added intangibles, the FTA has detailed some more explanations regarding the profit split method in a specific TP guide dedicated to small and medium-sized companies.

Published in 2006 to help small groups to better understand TP matters and to provide further clarification, including on a specific APA procedure dedicated to small entities, this guide details an example and a calculation to illustrate the way the method works. As the guide was drafted in 2006, and nothing further has been added since then, it clearly mentions that the profit split is a last resort method (see above on this aspect) and suggests that this method could be used as a corroborative one, to validate the consistency of the outcomes of a traditional method.

When used by tax auditors, the profit split method is of course linked to a strong functional analysis and a detailed scrutiny of the intangibles used by the group as well as the risks borne by the group entities. This means that if there is no specific rule or mechanism concerning the application of TP rules to MNE value chains, the way the analysis is performed during a tax audit is actually in line with Actions 8–10 OECD BEPS recommendations.

It is obvious during tax audit works that tax auditors carefully examine the transactions detailed by the group and take time to achieve a good understanding of the contracts. When possible, they also embed in the audit team people with an economic profile, in order to better understand the business activity of the group.

The last subject included in the scope of revision on the transactional profit split method mentioned by the BEPS report is the use of the profit split to determine the transactional net margin method (TNMM) range, royalty rates and other payment forms. Experience shows that the French tax audit services may accept this approach to a profit split to substantiate the rate of some kind of royalty (auditors of the national tax audit services in charge of the largest groups rather than other auditors).

When accepting such an approach, they also make a cautious examination of the functions and risks of the various entities of the group, in order to identify the value-added activities performed and the appropriate key remuneration drivers of the profits. This allows them to then better understand the value chain of the group at stake and to be able to challenge the profit splitting factors.

The FTA has not specifically reacted on this matter and it may be anticipated that it will not provide details on the use of this specific method before the end of 2017, when it is expected that the draft working party 6 guidance will be finalized.

3.5. TP documentation

3.5.1. CbCR

Soon after the BEPS report was published, France indicated that CbCR will be implemented and information will be provided to its partners. It is interesting to recall that the government was initially considering including a dedicated article in the Finance Law for 2016, at the very end of 2015, but Parliament has requested its introduction earlier, in another law connected to several aspects, including tax matters, leading to a validation of this article a few weeks earlier.

CbCR is mandatory for fiscal years beginning on or after 1 January 2016, under article 223 *quinquies* C of the French Tax Law. It is fully in line with the BEPS recommendations: the first report will be filed with the FTA before the end of 2017 and the information will then be shared with France's treaty partners. France actually signed the Multilateral Competent Authority Agreement on the exchange of CbCR on 27 January 2016, and was one of the first countries to sign it.

A decree is expected to detail this new mandatory reporting procedure, and the FTA has circulated several drafts. However, no specific explanations or formal guidance for its implementation has been provided by the FTA to date.

Early during the parliamentary discussions on the implementation in France of this CbCR, voices were raised to ask for an implementation of public CbCR. The Minister of Finance has explained that the French government was looking for the full implementation of the BEPS recommendations, but only the BEPS recommendations, explaining that public reporting could be a goal, as long as it was implemented at the same time by other partners.

This debate on public reporting is still alive in France: public CbCR is included in (a) two draft EU directives (one on accounting and one on shareholder rights) that still need work and (b) a draft French law related to transparency and the fight against corruption (article to be added to the commercial law). This French draft law will be discussed in Parliament before the end of 2016.

Moreover, this last draft law has also included a progressive decrease in the BEPS recommended threshold of €750 million. The current wording of that draft law provides for an initial decrease to €500 million in 2018 and to €250 million in 2020. At the same time, the FTA is also requesting the introduction in this law of an amendment to the Tax Law (article 223 *quinquies* C) to substitute a €50 million threshold instead of the €750 million from the BEPS recommendation.

3.5.2. Master and local files

Article L.13AA of the French Tax Procedure Law has introduced, starting on 1 January 2010, mandatory documentation to be provided to the tax auditor from the beginning of the tax audit. This article explicitly mentions the distinction between a set of general information connected to the group and a set of specific information connected to the French entity and the TP method.

The JTPF code of conduct on TP, validated in June 2006, has been the main reference of this article of the French law, as well as initiatives of other European Member States. This clarified the documentation and the information to provide to French tax auditors, but also increased the pressure on MNEs to present this information on TP very near the beginning of the audit procedure. Before the introduction of the article, it was difficult for tax auditors to access a clear set of documents to detail and prove the internal organization of the group and to have detailed and reliable information, in order to assess the MNE TP.

If this information is not available at the beginning of the tax audit, the French entity may face specific penalties, if this information is not provided in the 30 days following a formal request of the tax auditor.

As French tax law already includes this distinction between master file and local file, the Action 13 recommendations in this area will not lead to a major change in France. However, some information to be included in the master file following the BEPS Action 13 report is not currently mentioned by the French Tax Law, mainly:

- a description of the supply chain for the group's five largest products and/or services offering;
- a list and brief description of important service arrangements between members of the group (other than R&D);
- significant financing arrangements with unrelated lenders;
- the group annual consolidated financial statement for the fiscal year and a list and brief description of existing unilateral APAs and rulings.

However, for now, the FTA does not anticipate a change in domestic tax law.

3.5.3. Compliance costs

There is no specific domestic requirement and no discrepancy with OECD recommendations. Experience shows that mandatory TP documentation is not easy to prepare and to file with tax administrations. Even though the information may be somewhere in the accounts or in the IT systems of the groups, it is not always computed as such and may not usually be documented by the tax directorate of the groups or the local entities.

For example, one piece of CbCR information to mention on the form is the number of employees. This information, which may lead to a specific calculation when people outside a company will be included in the total number of employees (see the Action 13 BEPS report on the possibility of including employees of independent contractors, in specific situations), may be difficult to collect. Figures may also be difficult to sum up, due to the use of different reporting systems in a single group (when groups were built by several acquisitions for example).

The fact that this mandatory reporting and information has to be provided has led MNEs to invest in new tools and time to design the appropriate internal procedure to ensure useful information collection and ensure the quality of the figures provided. Groups have also been careful in drafting comprehensive reports and making sure that all useful information has been provided to the tax administrations/tax auditors.

These are direct costs connected to the implementation of the new CbCR requirement. MNEs are also anticipating indirect costs, arising from the possible reactions of tax auditors, who will investigate these international transactions in depth, using these new detailed information flows to ask more, very specific questions, probably aiming at reconciling the figures provided in the CbCR with figures included in other tax returns or mandatory reports, or even provided by other tax administrations under the exchange of information. This will be time consuming and expensive to manage.

The only specific requirement (effective in the French tax law at the end of 2013) arises from the mandatory TP report (article 223 *quinquies* B of the Tax Law) to be filed with the FTA, to provide an electronic report including general information about the group and its activities, and specific figures and elements on transactions and the TP method. However, no specific costs to be borne by MNEs are expected in France other than those connected with the implementation of CbCR.

3.6. TP-related measures in other BEPS actions and other measures against BEPS

As already mentioned, France is in a specific situation where most of the BEPS recommendations are already included in French tax law or implemented under tax audit procedure practices. This means that no specific action is anticipated in most of the other BEPS actions areas. If necessary, France will of course include in its domestic law specific measures arising from EU directives to align EU legislation with the BEPS recommendations.

In fact, what can be expected is the very dynamic participation of the French representatives in the coming works on the IT sector. France was one of the co-chairs of the BEPS group dedicated to Action 1. The interest of France in this area is obvious and it is certain that it will provide new ideas and will contribute to an evolution of the principles in that matter, if possible.

No information has been provided for now on the possible reaction of the FTA regarding the Action 5 recommendations. Knowing that France has an R&D regime which may be considered as not BEPS compliant, it may be expected that a careful examination of this regime will have been carried out. However, this regime has already been scrutinized in the EU context of the code of conduct (the Primarolo Group) and it has been validated.

Under Action 4, specific recommendations connected to financial expenses and financial transactions have been provided by the OECD. Most of them are already covered by French tax law, but the FTA may want to take this opportunity to clarify some of the existing legal provisions or to strengthen the French anti-abuse law. For example, interest limitation rules (also included in the Anti-Tax Avoidance Directive) may be adjusted, but they would certainly have an impact in the more general TP area as such a limitation may have an impact on the TNMM TP method for example, when the TNMM is designed to take into account the bulk of several intra-group transactions, including financial transactions.

Looking to Action 13, France has made it very clear that it is ready to include an arbitration clause in its tax treaties. It has indicated that it will systematically suggest doing so to its partners whenever a convention is to be negotiated or amended. France has said that it is willing to be one of the countries to sign the OECD multilateral instrument to ensure the effective introduction of the arbitration procedure.

3.7. Can BEPS work in favour of MNEs?

From a general point of view, the BEPS recommendations have been seen as a strong global strengthening of rules which will favour the position of tax administrations, especially when it is connected to a "substance-over-form" analysis and to the *ex post* approach. This is not a surprise as the BEPS works were intended to facilitate the fight against BEPS.

However, MNEs may be in a position to benefit from some of the BEPS recommendations, either from the limits to intangibles comparisons, from the optional approach of limited value-added services, from the improvement in the APA/MAP procedures or from the clarifications about cross-border commodity transactions.

Moreover, the focus of the BEPS recommendations on transparency may also be an opportunity for MNEs. For now, no specific initiative has been taken by the business or the FTA to specifically use the information which will be shared with the tax authorities in a way to favour taxpayers. But it is certain that groups may benefit from this move to gather and centralize all the information, not only in France but in other countries of course.

This move towards transparency and exchange of information would lead groups to collect, more systematically and on a larger scale, information that may have been somewhere in the accounts or in a specific subsidiary but has not been used to date. It may also lead to the setting in place of specific procedures or methodologies to find and keep information which was not collected before, or to collect much more detailed figures and indicators.

Having this information easily available may help MNEs to explain in more detail their position, their organization, their TP method and their profit allocation. It may also lead tax administrations to avoid challenging groups on some transactions or levels of remuneration, due to the fact that they may have a better understanding of the group activities and the transactions' organization.

4. The future of TP in France

It is certain that France will continue what has been its traditional approach for years, to enforce international TP principles and guidance, whether they come from the OECD (specifically the arm's length principle) or the EU, as well as taking into account genuine MNE international and operational organizations. In this context, the FTA is ready to deal with international transactions and explains that it is not specifically targeting MNEs when preparing its tax audit programme.

Bearing this context in mind, and from a general point of view, one would easily agree that the BEPS recommendations will probably lead to increasing pressure on businesses from tax administrations. This will be evidenced by a rise in tax audit numbers, by a more focused attention on TP from tax auditors, by higher amounts of TP tax reassessments, by a more common use of penalties in the area of TP tax reassessments, and probably by some countries investigating TP when they did not, or not so much, in the past.

Most of this will probably also happen in France, in the medium to long term, and actually seems to have already started with the momentum of the BEPS works. MNEs have seen (a) the amount of TP tax assessments increased and (b) penalties more often used in the TP area (either because a full set of information has not been provided or because the TP policy detailed by the group has not been fully implemented or was leading to what is called a "significant discrepancy"), where it was not in the past.

In France, a rapid growth in the amount of double taxation may be anticipated, arising either from French audit activity or from the tax reassessments of economic partners. This will naturally lead to an increase in MAPs, because this focus on TP matters may also be accompanied by a reluctance of most of the tax audit services to enter into an amicable discussion with groups (partly because of the use of penalties, as described above). At the same time, some of the treaty partners of France appear to have a less open APA approach, considering that they do not want/cannot work (a) on requests that are too difficult or (b) when the transactions at stake are said to be too challenging. France has not followed this avenue to date but may be tempted by a similar approach.

To face that situation, treaty partners may ask France to be part of joint TP audits or simultaneous TP audits, to work together and choose a consistent position on both sides of the border. Up until now, France has not been keen on this kind of joint tax audit procedure but may change its approach, to ease TP audit procedures and decrease the flow of MAPs.

Looking to the future from a more theoretical point of view, three main changes may be foreseen.

(a) The profit split may become a more common method. Knowing that it is difficult to find agreeable comparables (more difficult access to useful information, specificities in the rules of several countries to build a comparables study, less useful comparables in some industry sectors such as IT, tech-economy, collaborative economy development, etc.), this method may become more acceptable and less challenged, becoming the last reliable TP method in some situations. France seems not to be reluctant to use the profit method on a larger scale.

(b) The common consolidated corporate tax base (CCCTB) may be introduced soon in the EU and would lead to fewer concerns regarding some European transactions. The CCCTB implementation is one of the main goals of the European Commission, in the momentum of Brexit, in its attempt to invigorate European action and end current corporate tax competition. After the introduction of such a common corporate tax rule, and depending on the design of the CCCTB, some tax administrations, including the FTA, would then focus on other transactions than those performed within the CCCTB zone. This may decrease the overall number and amount of TP reassessments, but may increase the pressure on transactions with some countries and so may lead to specific technical problems with these countries, as well as a rise in the opening of MAPs.

(c) TP aspects may become a matter of concern for people outside of the traditional tax area. If more information is made public, this will become of specific interest for non-tax partners of MNEs, whether employees, NGOs, customers, shareholders or managers of the group. This has already started, in France as in other European countries, due to recent leaks and following the recent public actions of Mrs Vestager, the European Commissioner for Competition. Specific technical attention may then be needed to design a TP policy, which would have to be simple enough to be explained to the public, and to carefully ensure the full implementation of that policy, to avoid an adverse impact on the group brand and image.

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