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GLOBAL TAX

Responding to government tax audit, inquiry and investigation: a French perspective

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In recent years, the French tax authorities have been increasingly inquisitive with international businesses and investors doing business or providing goods and services in France or to be used in France.

Hundreds of inquiries have been initiated to establish the presence of undisclosed permanent establishments in France, including through physical searches of related French entities. Among them, a recent series of Paris court rulings in a Google case attracted attention because of the amounts involved and the favourable outcome for the taxpayer which could avail itself of a double taxation treaty and demonstrate the absence of a permanent establishment in France. The situation would change since France has adopted the new clauses inserted by the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI) with the view to "preventing artificial avoidance of permanent establishment status" (Articles 12 to 15 of the MLI implementing Action 7 of the BEPS project).

More often than not, international businesses do not litigate but rather enter into negotiations with the French tax authorities for a settlement.

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In the absence of a permanent establishment in France, the French tax authorities may wish to assess French withholding taxes on the gross amounts paid to or by French entities as royalties, compensation for services or dividends, especially in situations where the French authorities feel entitled to deny double taxation treaty benefits. Recent court precedents enable them to do so where the corporate entity established outside France is not effectively liable to corporation tax on its worldwide income as this would disqualify its tax residency under the relevant double taxation treaty.

The purpose of this article is not to present arguments to claim treaty benefits in France since they would very much depend upon the factual circumstances of each case. It is to provide certain general French practitioners' views on what would be a cooperative attitude of international businesses or investors confronted with a French tax audit, inquiry or investigation in such circumstances.

Undisclosed permanent establishments in France

Where the French tax authorities consider there is preliminary evidence of a permanent establishment in France, they are entitled to request a warrant from a judge in order to search certain premises they consider relevant and seize almost any document found in the searched premises. The foreign entity may challenge both the warrant and the search operations but such appeals seldom succeed in court. However, challenging the warrant may often be useful as it enables the potential taxpayer to access the documents supplied by the French tax investigators in their application for the warrant and bring forward certain points of defence to be considered, possibly at a later stage, by the French tax authorities.

After the search, the French tax authorities may use the collected documents against the potential taxpayer only after carrying out a full audit of its accounts with the assistance of a counsel and a discussion in person. The French tax authorities send simultaneously a request for omitted tax returns. Although the non-resident entity may claim it has no taxable presence in France where it maintains no corporate accounts and consider that it has no tax return to file in France, it is generally advisable to cooperate with the French tax authorities.

Under French tax law, any audited business must supply its accounts and supporting documents for inspection, in their original digital format where applicable. Where cross-border transactions occur with related parties, the audited entity must also make its transfer pricing policy available to the French tax auditors. As a result, the French tax auditors would expect, and generally require, to review such documents, failing which they are entitled to formally record that they were not presented and draw certain conclusions.

A non-resident entity which considers that it has no taxable presence in France presumably would not have separate accounts, or transfer pricing policy, with respect to its operations in France, especially where these operations are carried out by a French subsidiary or other related entity. As a matter of law, there is no requirement for a foreign entity to have separate accounts for its French operations, even where carried out through a permanent establishment. Business entities established outside France and doing business in France from abroad accordingly are entitled to indicate that they did not maintain separate accounts but should be prepared to provide the relevant

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documents to French tax auditors. The accounting documents could be their full set of accounts in their original digital format and any relevant transfer pricing policy.

Depending upon the circumstances, these documents may support the position that the entity had no, or a limited, presence in France, with no or limited tax consequences. This may be true especially where the deemed permanent establishment in France can be seen as merely supplying support functions to the head office and principal activities abroad. In such a situation, no VAT would apply, especially within the European Union, and the corporate income tax implications would not substantially differ from a transfer pricing adjustment, if any.

In anticipation of such possible outcomes, the potential taxpayer may defer to the request of the French tax authorities and file the corresponding tax returns within 30 days following the request to do so. In these tax returns, the foreign entity may indicate why there was no reportable VAT transaction in France or how the transfer pricing policy would result in no or limited taxable income attributable to the hypothetical French permanent establishment. If a reassessment occurs, the entity may claim treaty benefits where applicable and access the mutual agreement procedure.

This scenario implies that, at some stage, the investigated taxpayer makes the decision to either challenge the existence of the permanent establishment, including before the court, or to negotiate with the French tax authorities, concede the establishment and mitigate the French tax consequences.

As a means to press the non-resident entity for such admission, the French tax authorities may take the position that the permanent establishment was not only undisclosed but hidden or concealed. Such an ugly characterisation would result in an extended period of limitation (10 years instead of three or four) and the risk of a severe penalty (80 percent instead of 10 percent). Depending upon the circumstances, and the country of origin of the taxpayer, defences may be available either on both grounds or in relation to the penalty only.

Withholding taxes on income flows from France

In the absence of a permanent establishment in France, withholding taxes apply on certain types of income arising from France to non-resident taxpayers at rates ranging from 15 percent to 33 1/3 percent (in ordinary circumstances) on the gross amount paid. Most of these withholding tax obligations are waived or reduced by double taxation treaties, where applicable.

The trouble arises where a non-resident entity is not fully liable to tax in the country where it is established as the French courts have endorsed the view that such an exempt entity should not be regarded as a resident of the relevant country and should accordingly be denied treaty benefits. They reached this solution in situations where corporate taxpayers availed themselves of certificates of tax residency from their country of origin but were not effectively taxable there, either permanently or because of temporary tax holidays.

Further questions would arise with the limitations introduced by the MLI to prevent treaty abuse through Article 7 on the principal purpose test and Article 8 on the minimum shareholding period for dividend tax reduction (Action 6 of the BEPS project).

The position of the non-resident entity, and the French debtor or paying agent, is all the more

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uncomfortable, as French law does not expressly provide for a notification to the non-resident for its comments and requires a gross-up of the amount that was not, or was insufficiently, withheld.

Two defences may be considered by the non-resident corporate taxpayer. It might first ascertain its tax residency in its country of origin, possibly in conjunction with the tax authorities of such country, in order to support its status under the relevant double tax treaty with France. This could include assistance by means of exchange of information with French tax authorities.

Where the withholding tax cannot be avoided under the treaty, another defence is to claim a reduction of the rate and/or taxable basis on the basis of equal treatment with French residents receiving similar income. Where a French resident is entitled to deduct professional expenses from its net taxable income, it is appropriate for the non-resident taxpayer to supply its French debtor or paying agent with the relevant information, and evidence, of its own expenses or deductions in order to reduce the taxable basis of the French withholding tax.

In practical terms, when the non-resident entity is informed that an investigation or audit occurs in France in relation to the withholding tax, it should be prepared to present its defence to the French tax authorities and supply them with the relevant information and supporting evidence. ■