MOORE

TRANSFER PRICING BRIEF

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INTRODUCTION

Welcome to this issue of Moore Global's Transfer Pricing Brief. This is Issue No 4 of 2020, the year that will forever be remembered for the devastating worldwide coronavirus (COVID-19) pandemic.

This issue brings a special focus on Europe, North and East Africa and the Middle East, but we begin with two articles of general importance on issues arising from the economic impact of COVID-19. **Sven Helm**, Global Transfer Pricing Collaboration Group leader, discusses how it may be possible to adjust for the effects of COVID-19 on the results of low-risk routine entities. **Natalie Bissoli** of Bureau Plattner in Milan looks at how best to allocate intra-group losses arising from the pandemic.

We then welcome introductions from member firms in Kenya, Morocco and Lebanon to the transfer-pricing situation in their countries. **Joy Bhatt** of Moore JVB in Nairobi shows how transfer-pricing rules in Kenya have developed since their inception in 2006. **Kouds Bernossi** of Moore Bernossi in Tangier surveys Morocco's transfer-pricing rules from their first introduction in 2009, while **Hala Sakha** of Moore Tabbal in Beirut explains how the Lebanese tax authorities apply transfer-pricing principles in the absence of explicit transfer-pricing rules and regulations.

We conclude with a survey of transfer-pricing rules, this year's relevant jurisprudence and the impact of COVID-19 in France from **Nikolaj Milbradt** of COFFRA in Paris.

We hope that you find much of interest in this Issue and wish all readers the compliments of the season and best wishes for what one hopes will be a New Year in which we see a gradual retreat of the coronavirus.

THE EDITORS

IMPACTS OF THE COVID-19 PANDEMIC ON ROUTINE ENTITIES

SOLUTIONS FOR INTERNATIONAL TRANSFER-PRICING SYSTEMS

Even if the world is able to fight the coronavirus pandemic, the effects on the business world will be significant. Companies have to face serious challenges while trying to navigate the impacts of the COVID-19 pandemic. A period of an unpredictable economic recovery lies ahead of us. In the long run our world will be changed, which leads to a 'new normal' and a rethink of how the world does business. If international business models transform, the transfer-pricing systems of international groups will inevitably change. It is crucial to identify a possible need for change with regard to the current transfer-pricing model. The international transfer price itself shows the value-based representation of economic transactions between affiliated companies.

LIMITED RISK AND YET LOSSES

So-called routine function entities manage only simple activities and services. They neither own crucial remarkable assets (e.g. intangibles) nor do they carry out complex functions. These entities bear no high risks, such as investments. Losses (and profits) correlate with the functions taken over by an entity. Due to the absence of significant business risks and the low chance of taking wrong independent business decisions, operating results are highly likely to be predictable and plannable. This leads to the allocation of a rather low but secure and regular profit margin. Furthermore, this means that in a period without an economic downturn it is very unlikely to assume losses.

Similar to the financial crisis of 2008, an ongoing recession can reduce the margins and even lead to losses. Permanent losses of a routine-function entity represent the starting point for a detailed examination of transfer prices and their possible non-conformity to the arm's length principle.

REASONS FOR THE LOSSES

In the event of a loss, the cause of the loss must first be clarified. The unusual business development could be based on functions of the routine entity (e.g. damage to machinery due to a fire). It is acceptable if short-term losses resulting from the sphere of a routine-function entity lead to a loss situation for the same. Losses arising from the overall economic situation of the principal cannot generally be transferred to the limited-risk manufacturer. The principal performs most functions of the group and should be awarded the greatest part of the income, as it assumes the largest amount of risk. A 'crisis' in general and alone cannot be the cause of losses at the level of the routine entity. To the extent that in such a crisis significant losses are incurred outside the company's own area of responsibility, operational support measures will have to be considered by the principal.

At the same time, it might be acceptable under the arm's length principle for routine entities to take over part of the struggle from their business partners in times of crisis. The OECD's Transfer-Pricing Guidelines (OECD-TPG) suggest that independent companies would not accept a loss situation over an undefined period of time (OCED-TPG 2017, p. 80, para. 1.129). Short-term loss-making could be acceptable if it is strategically motivated and leads to the economic survival of the routine entity.

Assumption of losses by a limited-risk distributor due to an overall loss by the corporate group could be possible if these losses are compensated in the future by higher profit opportunities. The expected benefit and the disadvantage suffered from the intentional set-off should correlate with regard to the arm's length principle (OCED-TPG 2010, p. 111, para. 3.13). A third company would cover the losses only if there was an overall advantage. Problematic here is that future profit expectations may not be sustainable if the crisis persists.

ADJUSTMENTS TO MEET NEW CIRCUMSTANCES

Year-end adjustments may be another possibility, but resort should not be had to them to an excessive extent. Retrospective correction of transfer prices is only partially permissible. The prerequisite is that the price-determining factors have already been determined beforehand.

It has to be clarified in advance if adjustment clauses for the margin or short-term termination options are possible. A retrospective decrease of the margin for limited-risk manufacturers has to be fully documented and explained. All measures taken need to be covered by the underlying written agreements. The interpretation of the contract has to be based on the behaviour of a conscientious and orderly manager under comparable conditions.

In addition, it should generally be noted that any agreement is made subject to certain conditions. If the scenario changes, the agreement may have to be adapted to the circumstances. This also applies to agreements with tax authorities (e.g. 'rulings'), whereby a change of the transfer-pricing system may ultimately result from the arm's length principle.

It is important to note that loss situations require a high documentation effort. As a result, the best possible provision of evidence should be ensured. This can be achieved by the preventive effect of proactive documentation and overall preparation.

OVERALL STRATEGIC CHANGES

Only in specific individual cases, can and should the group's overall strategy be changed. The routine entity could take over functions and risks in the long run. From the tax perspective, a sufficient reason is needed to adjust the business strategy.

On the other hand, in the financing strategy, decentralised finance companies might need to exercise more central control (e.g. through cash pools). Regarding cash-pooling agreements, reference should be made to the provisions of the OECD's recent Transfer-Pricing Guidance on Financial Transactions, published in February 2020 (OCED 2020, p. 23, para. 10.109).

The assessment of the appropriate transfer price is particularly challenging where intangible assets are transferred between associated enterprises. In the presence of a pandemic, it may be debatable whether third parties would have made price adjustments. Intangible assets already transferred may also be affected. In the event of transfer for use within the group, the amount of the licence fees for intangible assets may also be adjusted in conformity with the arm's length principle.

FUTURE DEVELOPMENTS

Losses in times of economic recession not only affect company owners, but also cause the whole business world to undergo change. It is not possible to make a secure prognosis of future developments for either the business world or the world in general, which creates uncertainty and makes business decisions more difficult. In order to make sure that one always uses the correct transfer-pricing system, reacting in a fast and well-considered way is of the utmost importance.

The current COVID-19 pandemic is an unpredicted extreme event. In practice, we are seeing even more intensive discussions with the tax authorities. Some of them seem not to be open for adjustments in terms of transfer prices due to the coronavirus crisis. This does not make things easier but makes a thorough and constant analysis by TP experts even more necessary.

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ALLOCATION OF INTRA-GROUP LOSSES IN THE TIME OF COVID-19

Over the coming months, multinational groups will be called upon to assess the effects of the epidemic crisis on their balance sheets and, in particular, to identify alternative ways of managing transfer pricing in the light of the (unavoidable) operating losses realised in 2020. As a result of the lockdown and the slow recovery in progress, multinational groups have estimated a significant drop in turnover and have therefore been updating their budgets.

In such circumstances, transfer-pricing policies that guarantee minimum margin levels for low-risk entities (e.g. limited-risk distributors and contract manufacturers) are among the first to be questioned. In fact, in some cases, the reduced revenues may not be sufficient to cover fixed costs and to guarantee the achievement of the minimum remuneration level established by the group's transfer-pricing policy. This circumstance may become more or less evident depending on the country, activity and sector of reference, as well as on the amount of incentives and state aids received by the individual entities.

The parent company will have to assess whether the actual transfer-pricing ('TP') policy is still reliable and, if so, will have to provide the necessary adjustments in order to guarantee a minimum remuneration to the low-risk subsidiaries, bringing them back to profit, with a consequent increase of its own loss.

Such an approach could seem to be at odds with the current scenario and with the correct application of the arm's length principle, as an accurate analysis should take into account the extraordinary contingencies that have affected the operating result. However, benchmark analyses usually prepared to support the TP policy actually applied, will hardly give reliable results for 2020 and will probably not be helpful, not even through the application of cautious adjustments (e.g., inclusion of loss-making comparables, extension of the analysis period, adjustments to the income statement of the comparables or of the tested party). Yet, in the absence of official guidelines, the various tax authorities could continue to adopt this standard approach they are used to, even though with the application of appropriate adjustments – although in the current scenario it is unclear which ones.

Nevertheless, an alternative assessment method could be based on a logic similar to those of the so-called profit-split method, though allocating losses instead of profits.

In more detail, one could envisage a consolidated income statement in order to determine the 'theoretical' loss at the group level, calculated gross of possible tax incentives and state aids obtained by individual entities. Such a theoretical loss could be split between each group entity through a reasonable allocation key (e.g. splitting based on the relative weight of the costs incurred by each of the related companies), in compliance with the arm's length principle. Such an allocation mechanism for inter-company losses, alternative or rather corroborating with respect to the usual TP logic, would allow verification of whether the negative impact on income statement of individual entities – gross of any state aid received, which is not distributable – can be considered reasonable (or sometimes even over- or underestimated) in view of the extraordinary economic situation resulting from the COVID-19 emergency. That would also validate the assumption according to which, in these specific circumstances, the application of traditional transfer-pricing adjustments should not be an option worth considering.

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TRANSFER PRICING IN KENYA

The Income Tax (Transfer Pricing) Rules, Legal Notice No 67 of 2006, published under section 18(8) of the Income Tax Act (ITA) (Cap 470) of the Laws of Kenya, came into operation on 1 July 2006 to provide direction on how an entity should comply with the arm's length rule including the basis of determining the arm's length price at which transactions should take place, and the relevant records and documentation that are required to be maintained.

According to Legal Notice No 67, the regulations apply to:

- transactions between associated enterprises within a multinational company, where one enterprise is located, and is subject to tax, in Kenya, and the other is located outside Kenya and
- transactions between a permanent establishment and its head office or other related branches, in which case the permanent establishment is treated as a distinct and separate enterprise from its head office and related branches.

When business is conducted between a non-resident and a related Kenya resident, the Commissioner (the tax authority) has the authority to alter the profits of the Kenya resident to what would be expected had the business been conducted between independent parties. 'Related enterprises' are defined in the regulations as:

- one or more enterprises where one of the enterprises participates directly or indirectly in the management, control or capital of the other or
- where a third person participates directly or indirectly in the management, control, or capital of both.

TYPES OF TRANSACTION

The Kenya Revenue Authority (KRA) scrutinises companies to ensure that these transfer-pricing rules have been applied to a range of transaction types. These include:

- the sale or purchase of goods
- the sale, purchase or lease of tangible assets
- the transfer, purchase or use of intangible assets
- the provision of services
- the lending or borrowing of money
- and any other transactions that may affect the profit or loss of the enterprise involved.

METHODS ACCEPTED

There are a range of acceptable transfer-pricing methods that can be utilised in the determination of the arm's length price. These are divided into transaction-based methods and profit-based methods. The most appropriate method should be applied to different businesses based on the nature of the transactions carried out by the business and the availability of comparable data within the functions performed.

The use of other methods may also be acceptable as prescribed by the KRA from time to time, where in the authority's opinion and in view of the nature of the transactions, the arm's length price cannot be determined using any of the methods above.

DOCUMENTATION

The KRA may request to see documentation as per the regulations for the transfer-pricing policies adopted by a business for its transactions at any time. These include documents (prepared in or translated into English) relating to:

- the selection of the transfer-pricing method and the reasons for the selection
- the application of the method, including the calculations made and price-adjustment factors considered
- the global organisation of the enterprise
- the details of the transactions under consideration
- the assumptions, strategies, and policies applied in selecting the method
- and such other background information as may be necessary regarding the transaction.

There are no specific deadlines for the preparation or the submission of the transfer-pricing documentation. Businesses are generally accorded time by KRA to prepare and submit the requested documentation.

No business, however small, or however insignificant or immaterial the related party dealings are, is exempt from application of the transfer-pricing policy and the arm's length principle. Abridged and simplified versions of the transfer pricing policies are not acceptable by the authority either.

INVESTIGATION AND PENALTIES

The provisions of the ITA relating to fraud, failure to furnish returns and underpayment of tax apply with respect to transfer pricing. Any tax due and unpaid in a transfer-pricing arrangement is deemed to be additional tax for the purposes of sections 94 and 95 ITA. Generally, the KRA may make an assessment seven years from the year the income was earned; however in the presence or suspicion of fraud or negligence in transfer pricing, the KRA has no time limit within which it has to make an assessment.

In the event that the KRA believes that the arm's length principle has not been adhered to, a transfer-pricing adjustment has to be enforced. In such cases, a general penalty of 20% of the principal tax and late-payment interest of 2% per month is applied. There are no special penalties.

In terms of missing documentation, there is no specified penalty for lack of relevant transfer-pricing documentation. Upon request from the KRA, the company is given some time to submit the documentation to the authority.

BURDEN OF PROOF

The burden of proof lies on the taxpayer to demonstrate that its transfer-pricing policies are reflective of the true business functions and activities, and that its transactions are in compliance with the arm's length standard.

COMPARABLE DATA

According to the OECD guidelines and the local transfer-pricing guidelines, data gathered on the activities of similar independent third-party companies would be satisfactory and adequate to use in a transfer-pricing policy. The KRA expresses a preference for local comparatives, especially where comparable uncontrolled prices are readily available.

Availability of information on listed public and private companies in Kenya is very limited, making it hard to compare data of other similar companies. The only available information is published interim and annual financial statements of public listed companies. In this case, it is generally acceptable, and a preference of KRA, to use benchmarking and financial databases from around the world, with a focus on the Amadeus/Orbis database. Various geographical, economic and other adjustment factors would, however, need to be applied to these data before they can be used as a comparable to local data.

ADVANCE PRICING AGREEMENTS

There are currently no procedures in place in Kenya for an advance pricing agreement.

COUNTRY-BY-COUNTRY REPORTING (CBC)

CbC reporting standards have not yet been adopted locally by Kenya.

JOINT INVESTIGATIONS

The KRA is part of the African Tax Administrators Forum (ATAF), a body that is partly responsible for enhancing the technical expertise of African tax authorities. It also provides a platform which allows cooperation on matters such as transfer pricing among African tax authorities.

Moreover, as of 26 November 2019, Kenya is a signatory and party to the OECD Multilateral Convention to Implement Tax-Treaty Related Measures to prevent Base Erosion and Profit Shifting (BEPS). This convention with the OECD/G20 BEPS Project delivers solutions for governments to close the gaps in existing international rules that allow corporate profits to disappear or be artificially shifted to low- or no-tax environments where companies have little or no economic activity.

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TRANSFER PRICING IN MOROCCO

INTRODUCTION

Morocco is a country that traditionally receives significant foreign investment: around MAD 47 000 million (USD 5171 million; EUR 4337 million) per year, which represents 4% of GDP.

As a consequence, numerous companies are subsidiaries or branches of foreign companies, with significant internal transactions of services and goods.

The topic of transfer prices ('TP') was first mentioned in the Finance Act for 2009 which provided, under article 213 of the General Tax Code ('GTC'), 'Where a company is directly or indirectly dependent on companies located in Morocco or outside Morocco, the profits indirectly transferred, either by way of an increase or decrease in the purchase or sale price, or by any other means, are related to the taxable income and/or revenues reported. With a view to this correction, the profits indirectly transferred as indicated above shall be determined by comparison with those of similar undertakings or by direct assessment on the basis of information available to the administration.'

Therefore, companies subject to a tax audit can see the inspector question the transfer pricing applied within the group and recalculate the basis of corporate tax.

In 2015, the Finance Act introduced the possibility of concluding a preliminary agreement with the tax authority (an advance pricing agreement, 'APA'), by means of article 234 *bis*, 234 *ter* and the decree No°2-16-571. The application for an APA must be made at least six months before the first day of the fiscal year covered. The agreement is valid for four years, and the tax authority is not allowed to question the price of transactions mentioned in the agreement, unless the company has provided false data or information in support of the application or fails to apply the methods of calculation agreed upon.

Applications for an APA have been quite scarce to date, as companies have been reluctant to disclose confidential data.

Morocco joined the BEPS process in March 2019. That year's Finance Act introduced the obligation to present appropriate documentation regarding transfer pricing and the 2020 Finance Act introduced the obligation to make CbC reports, following OECD decisions and, in particular, BEPS Action 13. The intention is that when a tax audit takes place in 2020 and thereafter, companies must present their TP documentation explaining the transfer pricing applied within the group. However, this is still not the case in practice, since the implementing Decree has still to be enacted.

The TP documentation must comprise a complete compendium of pricing policy applied to cross-border transactions containing:

- The nature of the relationship between the companies
- The nature of the services or products marketed
- Corporate tax regimes and rates outside Morocco
- TP data for the activities concerned
- The distribution of profits
- Information on transactions between local and foreign companies

It would appear that what is required goes somewhat beyond the OECD norm.

Companies that have to make CbC reports are mainly those who prepare consolidated financial statements and whose consolidated turnover is equal to or exceeds the equivalent of EUR 750 million and are not a subsidiary of any other company. CbC reports must also be made by certain other companies, among them those that are subsidiaries of companies based in a country where a CbC report is not mandatory.

Where a company breaches the rules regarding TP, there is no specific penalty.

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TRANSFER PRICING IN LEBANON

Lebanon does not have explicit transfer-pricing rules and regulations. Nevertheless, since 2009, several steps have been taken in this direction.

With the introduction of Tax Procedure Law No 44 in Lebanon, which became effective on 1 January 2009, brief provisions regarding the treatment of related-party transactions from a Lebanese perspective appeared on the statute book. The provisions acknowledge the difference between form and substance and introduce certain fair market-value concepts for evaluating related-party transactions. Although specific transfer-pricing guidelines do not yet exist in Lebanese law, it does prescribe to the use of the arm's length principle. Like many Middle Eastern countries, Lebanon has a relatively low corporate tax rate at 17%.

TAX PROCEDURE LAW NO 44

The implementing regulations for this law ('the TPL') provide further guidance on the scope and condition of its application.

The general objective of the TPL is to improve the tax administration's work and to maintain (or establish) taxpayers' rights. Despite its purely administrative nature, as part of its income tax law, the TPL specifies an anti-avoidance rule that stipulates that when profits have been shifted abroad by deviating from 'normal' prices and conditions, such prices will be adjusted and added back to the taxpayer's taxable profit in Lebanon.

Moreover, the tax administration has the right to modify the value and conditions of transactions between related parties based on the arm's-length principle. The tax administration has the right to reclassify the transaction in either of the two following cases:

- A fictitious transaction, defined as a transaction where the value of a transaction differs by 20% (less or more) from the fair market value.
- A transaction that is legal in its form but lacks the necessary economic substance.

DEFINITION OF RELATED PARTIES AS PER THE LEBANESE TAX AUTHORITIES

According to Article 10 TPL, parties are considered related if one party has control and supervision over the other – that is, one party has managing authority over the other party, which gives the former party financial and economic influence over the latter party from a regulatory perspective. Article 4 of Decision 453/1 further specifies that parties are considered related if they demonstrate:

- supervision and orientation powers
- a subordination relationship
- a tutorship relationship or
- are jointly liable partners.

Moreover, Article 4 of Decision 453/1 also provides concrete examples, where supervision and orientation powers are deemed to exist, including:

- Where a natural or legal person possesses the majority of the capital conferring a majority of the voting rights or conferring the ability to nominate more than half of the company's board of directors.
- Where a natural or legal person is entitled by the company's board of directors to take decisions concerning the financial, economic and organisational (administrative) management of the company, even if not possessing more than 50% of its capital.
- Possession by a person of more than 50% of the company's shares.
- Person holding the right to obtain more than 50% of the partnership's profits.
- One person owning many enterprises.
- Many related persons owning more than one enterprise.

The rights or powers of an individual's spouse, siblings and descendants (whether or not adult) in the direct line are aggregated with an individual's rights or powers in determining the status of 'related persons' for tax purposes.

TRANSFER-PRICING METHODS

The Lebanese regulations do not contain any reference to specific transfer-pricing methods, but do prescribe the arm's-length principle.

RELEVANT REGULATIONS

Every person, establishment or company that satisfies either of the following conditions, even if not resident in Lebanon, is considered to be resident in Lebanon for tax purposes (i.e. as having a permanent establishment in Lebanon):

- Having available an office or fixed place of business in its name in Lebanon, even if it is not carrying on its business activity in a normal and repetitive manner.
- Practising a profession or business activity in a normal or repetitive manner, even if does not have a known registered place of business in Lebanon.

BURDEN OF PROOF

The burden of proof lies first with the taxable person concerning its tax return (self-assessment). If the tax administration wishes to raise additional assessments, the burden of proof shifts to the tax authorities.

DOUBLE TAX TREATY NETWORK

Until 1995, Lebanon had only one double tax treaty (DTT) and that was with France. As at February 2020, Lebanon had entered into DTTs with 29 countries and is currently in negotiation with 19 additional countries.

ANTICIPATED DEVELOPMENTS

For the time being, no detailed transfer-pricing regulations have been developed in Lebanon, but detailed transfer-pricing guidelines are expected to be issued in the near future. The increased use of transfer-pricing methodologies within the region (by tax administrations and taxpayers) has had an impact on the tax base in Lebanon, and the Lebanese tax authorities are working on their transfer-pricing regime in response to this trend.

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TRANSFER-PRICING DOCUMENTATION REQUIREMENTS IN FRANCE AND IMPACT OF THE COVID-19 CRISIS

Strict transfer-pricing documentation provisions apply in France, depending on the size of the multinational enterprises (MNEs) involved in cross-border transactions. Most documentation must be made available to the French tax authorities in the event of a tax audit, and some other documentation must be automatically filed each year.

Special attention must be paid to the pricing of intra-group transactions, especially in the unprecedented context of the COVID-19 crisis.

TRANSFER-PRICING DOCUMENTATION REQUIREMENT FOR LARGE COMPANIES

French companies or French permanent establishments of foreign companies which meet any of the criteria listed below have been subject to specific transfer-pricing documentation requirements since 1 January 2010 (under art. L13AA of the French Tax Procedures Code – *Livre des procédures fiscales*):

- Turnover or gross assets on the balance sheet exceeding EUR 400 million or
- A direct or indirect holding of more than 50% of the share capital or voting rights in a subsidiary meeting these thresholds or
- A direct or indirect holding of more than 50% of the share capital or voting rights by a shareholder meeting these thresholds or
- Membership of a French tax-consolidated group that includes at least one legal person meeting these thresholds.

These entities are required to draw up transfer-pricing documentation and to file a reduced version to the French tax authorities in respect of each financial year. See below for the annual filing requirement for medium-sized and large enterprises.

The transfer-pricing documentation is split into two files: the Master File and the Local File. Their required content was updated in 2018 to comply with the new OECD standards (Decree, 29 June 2018).

MASTER FILE

The Master File must give an overview of the group's activities, the global transfer-pricing policy and the global profit distribution.

This file is divided into five sections:

- The group's organisational structure: chart of the group's legal and capital structure and the operating entities' geographical locations

LOCAL FILE

The Local File contains more precise information about the associated companies of the company undergoing audit than those mentioned in the Master File and about specific inter-company transactions.

This file is divided into three sections:

- The French entity
  - A description of the governance structure and an organisational chart of the company
  - A description of the activities performed and of the company's strategy, indicating if the company has been involved or affected by business reorganisations or transfers of intangible assets during the financial year or the previous financial year
  - Identification of the main competitors.
- Controlled transactions
  - A description of the important transactions, i.e. transactions exceeding EUR 100 000 in the financial year with associated companies and of the conditions under which they were carried out
  - Amount of the intra-group payments and revenues for each type of transaction
  - Identification of the associated companies involved in each category of controlled transactions and of the relationship between the company in question and its associated companies
  - Copies of all important intra-group agreements concluded by the company in question
  - Comparability analysis and functional analysis of the company in question and its associated companies for each type of transaction
  - Indication of the transfer-pricing method for each type of transaction and the reasons why the method applied was chosen
  - Indication of the associated company chosen as the tested party
  - Assumptions made to apply the transfer-pricing method
  - List and description of the comparable transactions on the free market
  - Financial information used to apply the transfer-pricing method
  - Copy of the existing prior transfer-pricing agreements and of the decisions of other tax authorities linked to the controlled transaction
- Financial information
  - Annual financial accounts of the company in question
  - Tables with financial data in relation to comparable transactions used.

This documentation, which does not replace the supporting documents for each transaction must be made available to the French tax authorities from the start of a tax audit. The documentation is regarded as complete when it allows the French tax authorities to assess the transfer-pricing policy of the company as a whole.

Failure to submit the report is punished by a penalty, which is not less than EUR 10 000 and is the greater of (a) 0.5% of the amount of undocumented transactions and (b) 5% of the transferred profits relating to those transactions.

ANNUAL FILING REQUIREMENT FOR MEDIUM-SIZED AND LARGE ENTERPRISES

As from 6 December 2013, France reinforced its legislation against tax fraud by introducing a filing requirement that has been codified under art. *223 quinquies B* of the *Code Général des Impôts* (French Tax Code).

Taxpayers who are subject to this requirement must file a transfer-pricing return no later than six months after the deadline for filing their corporate tax return for the preceding financial year.

Enterprises that are required to file an annual return regarding the group's transfer-pricing policy are enterprises located in France and which meet any one of the following conditions:

- Turnover or gross assets on the balance sheet of at least EUR 50 million
- Direct or indirect holding of more than 50% of the share capital or voting rights in a subsidiary meeting these thresholds
- Direct or indirect holding of more than 50% of the share capital or voting rights by a shareholder meeting these thresholds
- Membership of a French tax-consolidated group that includes at least one legal person meeting these thresholds.

These entities must provide their transfer-pricing documentation justifying the prices of their inter-company transactions upon request of the tax authorities in the course of a tax audit.

Failure to submit the return results in a penalty of EUR 150. Omissions or inaccuracies result in a penalty of EUR 15 for each omission and misstatement, but no less than EUR 60 and no more than EUR 10 000.

COUNTRY-BY-COUNTRY (CBC) REPORTING FOR VERY LARGE ENTERPRISES

As from 1 January 2016, there is an obligation on certain large enterprises to file a country-by-country (CbC) report. This obligation is codified under Art. 223 *quinquies C* of the French Tax Code.

This obligation, which comes in addition to the other transfer-pricing documentation requirements, applies to French-resident companies or French permanent establishments of foreign companies that meet all the following criteria:

- They draw up consolidated accounts
- They own or control, directly or indirectly, legal entities located outside France or have foreign branches
- They generate annual consolidated tax-exclusive turnover of EUR 750 million or more
- They are not themselves in the ownership of one or more legal entities established in France that are ready subject to the French CbC reporting requirement, or of a legal entity located outside France that is subject to similar requirements under its domestic law.

For each state or territory in which the group is located, the annual CbC report must include the following information:

- Turnover from intra-group transactions
- Turnover from transactions with independent parties
- Total turnover
- Pre-tax profit or loss
- Income taxes paid
- Income taxes accrued
- Registered share capital
- Undistributed profits
- Number of employees on a full-time basis
- Tangible assets other than cash and cash equivalents.

The report must contain, for each state or jurisdiction of establishment, the identity of all the entities established there, including branches attached to a legal person situated in another state or territory. The nature of the main activities of each entity has also to be reported.

The CbC report must be submitted online to the French tax authorities within 12 months of the end of the group's financial year.

Failure to submit the report is punished by a penalty of up to EUR 100 000. Omissions or inaccuracies result in a penalty of EUR 15 for each omission and misstatement, but no less than EUR 60 and no more than EUR 10 000.

LATEST CASE LAW

Interest rates for intra-group loans

In a decision dated 10 July 2019 (CE, 10 July 2019, No 429426, SAS *Wheelabrator Group)*, the *Conseil d'Etat* (highest administrative court in France) ruled on the possibility of using bond benchmarks to justify the interest-rate norm of an intra-group loan.

Up to that point, the law considered that these interest rates were equivalent, within the limit of the reference rate set in Art. 39-1-3 of the French Tax Code ('CGI'), to those that the company could have 'obtained from independent financial institutions or organisations in similar circumstances' (Art. 212-1 CGI).

This has led to some disputes with the tax authorities for companies unable to provide the required evidence when they have taken out loans at rates higher than the reference rate. In fact, the tax authorities required the production of a firm bank offer for a loan like intra-group financing. This implies an onerous process for the company, leaving them unable in some cases to provide the required evidence.

In this decision, however, the *Conseil d'Etat* rejected this restrictive approach of the tax authorities and took a decision in accordance with the OECD's commentary on transfer pricing. The OECD suggests that a 'realistic alternative to an intra-group loan may be a bond issue'. The Court held that evidence of the arm's length principle of an interest rate could be demonstrated by any means and in particular through studies based on bond benchmarks provided by the taxpayer.

However, taxpayers will still have to ensure the relevance of the benchmark studies that they submit in a step-by-step approach:

1. Identify the borrower's risk profile (scoring)
2. Search for comparable bond data on the basis of the borrower's scoring
3. Identify an arm's length interquartile range on the basis of the bond data obtained

Management fees

In a case involving SAS Groupe LAGASSE EUROPE, decided on 28 January 2020, the Versailles Administrative Court of Appeal held that management fees paid by a French company to a foreign company in the same group were not deductible because these payments would have had no counterpart. This decision affirms previous case law on this subject.

In this case, the Court confirmed this position, pointing out that simple invoices and an agreement for the provision of services between the two companies, without any other material evidence, are not sufficient to show that the service was actually provided according to Arts. 39 and 57 CGI.

The burden of proof falls on the tax authorities, but it is up to the taxpayer to provide elements to refute the presumption that the administration has created.

It is thus necessary for companies to be able to:

- Prove the existence of paid services by any means of proof
- Verify that the service is of interest to the beneficiary and that it does not duplicate any other service and
- Assign the right value to the service.

Taxpayers will therefore be able to refer to the transfer-pricing documentation, which could then serve as a reliable source in the event of a dispute with the tax authorities.

IMPACTS OF THE COVID-19 CRISIS

Given the economic and financial impacts of the COVID-19 pandemic, companies will have to readjust their transfer-pricing policy. In this context, most of the transactions concluded prior to the pandemic are not comparable to current and future transactions. It will therefore be necessary for companies to adjust the compensation granted to the various entities for the 2020 fiscal year to avoid infringing the arm's length principle.

The OECD has provided guidelines on the allocation of profits in cases where a company cannot reliably estimate by comparability the different contributions of entities. This process can also be followed in the context of loss sharing. According to the OECD, the relevant profits to be shared are those of associated enterprises resulting from controlled transactions. Transactions should be accurately identified and defined to determine the income and expenses relating to those transactions. Finally, these financial data should be put on a common basis in terms of accounting practice and currency and then be combined.

The transfer-pricing documentation will have to include (cf. the requirements for large companies):

- Detailed explanations of the potential adjustments made
- The reasons why these adjustments are considered appropriate
- How they were calculated
- How they modified the results for each comparable entity and
- How they improved comparability.

Finally, if the expected economic rebound occurs by 2021, companies that have made transfer-pricing adjustments will have to make the same adjustments in the opposite direction. Companies may have to refer to comparable data from pre-crisis financial years.

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