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France

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In the latest version of Chapter VI[2], the Organisation for Economic Co-operation and Development ("OECD") has introduced a new framework to address the audit of "Hard To Value Intangibles" ("HTVI"). This framework was initially developed in the context of the "special measures, either within or beyond the arm's length principle", as a measure to account for the asymmetry of information between tax administrations and taxpayers[3].

As such, the OECD recommends that lawmakers enact appropriate legislation so that in certain circumstances, "tax administrations [would be entitled] to consider ex-post outcomes as presumptive evidence about the appropriateness of the ex-ante pricing arrangements"[4].

In this respect, the OECD points out that such reconsideration may not be applied in cases where:

- "Any significant difference between the financial projections and actual outcomes mentioned [. . .] does not have the effect of reducing or increasing the compensation for the HTVI by more than 20% of the compensation determined at the time of the transaction."

- "A commercialization period of five years has passed following the year in which the HTVI first generated unrelated party revenues for the transferee and in which commercialization period any significant difference between the financial projections and actual outcomes mentioned in i) 2 above was not greater than 20% of the projections for that period."[5]

As a general rule, the HTVI framework may not apply if the taxpayer provides reliable evidence that, when the transaction occurred, it reflected arm's length dealings. The OECD explicitly states that such evidence may take the form of:

- "Details of the ex-ante projections used at the time of the transfer to determine the pricing arrangements, including how risks were accounted for in calculations".

- "Reliable evidence that any significant difference between the financial projections and actual outcomes is due to:

  a) unforeseeable developments or [. . .]; or

  b) the playing out of probability of occurrence of foreseeable outcomes [. . .]"[6]

As such, the framework does not contradict the principle according to which pricing at arm's length should be determined based on the facts and circumstances[7] when the transaction is made:

- "Where the tax administration is able to confirm the reliability of the information on which ex ante pricing has been based, then adjustments based on ex post profit levels should not be made".

Issue One

Does your country have specific rules granting tax authorities the ability to either: a) consider actual results as a relevant factor when examining the arm's length nature of ex-ante pricing; or b) use actual results to adjust ex-ante pricing? If so, what items or transactions are covered by those rules?

The French transfer pricing regulations are not very extensive. They primarily revolve around Article 57 of the French Tax Code. One may also cite Article L13AA of the French Tax Procedure Code and Article 223 *quinquies* B of the French Tax Code, which relate to French contemporaneous documentation requirements. The core of Article 57 is:

i. the consideration of the price of products and services, and

ii. the comparison with comparable independent companies.

As such, there is no specific regulation covering the consideration of actual results vs. *ex-ante* forecasts for the transfer of intangibles.

In particular, Article L13AA, which refers to "methods to determine transfer prices," does not explain whether such methods ought to be used for price setting, for price testing or for both purposes.

Issue Two

What is the general practice of the tax authority on this point when auditing taxpayers? Does the tax authority make ex-post adjustments? If so, how are they generally applied in practice (and in particular, how is the adjustment made)? Is there a time period beyond which the rules can no longer be applied? Can taxpayers also apply the rules and make ex- post adjustments considering actual results?

Our experience shows that field auditors, in the course of the tax audit, usually consider all available information, including *ex-post* results, to establish their (re)assessment of intangibles transfers.

But one should not, however, expect that that this approach will be taken in every audit. The actual conduct of an audit very much depends on the individual field auditors who are managing the audit.

As an additional comment, please note that the French Tax Administration ("FTA") is widely known to have used penalties for willful offences or fraudulent behaviour (40% or 80%) during transfer pricing audits. This was unusual until just a few years ago. In the case of substantial variance between *ex-ante* and *ex-post* financials, one should consider the risk that the FTA would seek to apply such penalties.

Furthermore, taxpayers may include a contingent pricing clause in the terms and conditions of a contract covering intangibles transfer, to the extent that the agreement is arm's length. Please note that such clauses will have an impact on the pricing clauses, all things being equal. However, as a general matter, *ex-post* adjustments will most often increase the FTA's scrutiny, especially when the adjustment is detrimental to the French taxable income.

Issue Three

Are there exceptions to the legal or practical application of ex-post adjustments based on factors similar to those considered in the final OECD guidance on HTVI released on October 5, 2014? Specifically, are there exemptions related to the demonstration of the reasonableness of projections, exceptions for differences between projected and actual results within certain orders of magnitude, or time-based exemptions? Do any other exceptions apply?

From a legal perspective, statute of limitation rules apply directly to the application of the HTVI framework. These rules prevent the tax administration from reassessing a transfer that took place during a statute-barred year. In France, the statute of limitations is three years, but exceptions may apply, such as in instances of loss carry-forward, or if the tax administration establishes that an "abuse of law" has taken place.

From a practical standpoint, field auditors are generally aware that they should consider the terms and conditions of a transaction under the circumstances at the time of its inception. They also know that they should seek to factor in the respective knowledge of the parties at the time of the transaction.

As such, thorough and contemporaneous transfer pricing documentation is more than ever a must-have in case of transfer of intangibles. It should be noted that the FTA is very suspicious when considering forecasts prepared specifically for tax purposes. As a matter of best practice, such forecasts should be robustly substantiated by undisputable, external sources. The options that are realistically available to the parties at the time of the transaction are likely to be decisive in analyzing the transfer of an intangible.

Issue Four

What changes in domestic law and administrative practice do you expect, if any, associated with the finalization of HTVI guidance by the OECD?

Predicting the evolution of tax regulations is difficult, given that French lawmakers have a certain reputation for being unpredictable.

Yet, it should be emphasized that France has been consistently at the forefront of the BEPS Action Plan, promptly enacting or pre-empting domestic law measures promoted by the OECD, such as the Country-by-Country Reporting. It is likely that, at some point, French lawmakers will consider whether changes to French tax law are needed to account for the HTVI guidance. Such changes could vary from a limited change to the tax law, focusing on issues including the statute of limitation rules, to a more fundamental reshuffling of French transfer pricing legislation, especially of Article 57. Please note that it is highly unlikely that these regulations would be applied retroactively, but that cannot be completely ruled out.

From an administrative standpoint, the HTVI guidance is likely to have its most direct impact by increasing the awareness of field auditors with regard to intangibles transfers in general, and more particularly, to audit them in light of *ex-post* results as they usually already do.

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NOTES

[1] The views expressed in this article are solely those of the author, and are not necessarily the views of NERA Economic Consulting.

[2] OECD/G20 Base Erosion and Profit Shifting Project – Aligning Transfer Pricing Outcomes with Value Creation – ACTIONS 8-10: 2015 Final Reports, (the "BEPS Report") Section D.4., October 2015.

[3] BEPS Action 8, 9, 10, Discussion Draft on Revisions to Chapter I of the Transfer Pricing Guidelines (including Risk, Recharacterization and Special Measures), December 2014.

[4] Section 6.192 of the BEPS Report.

[5] Section 6.193 of the BEPS Report.

[6] Section 6.193 of the BEPS Report.

[7] Including, amongst others, the knowledge of the parties dealing at arm's length.