

**Summary of the French Tax Authorities' Instruction of December 23, 2010 4 A-10-10
commenting on the new transfer pricing regulation relating to the documentation obligation
(art. 1735 ter of the French Tax Code (FTC), art. L. 13 AA, L. 13 AB and L. 80 E of the French
Tax Procedure Code (FTPC))**

Office E1

This text translated by Arsene Taxand is an unofficial version of the Instruction

CHAPTER 1 : SCOPE OF THE DOCUMENTATION OBLIGATION

Pursuant to Article L. 13AA of the FTPC, the documentation obligation targets companies based in France:

- a) whose yearly turnover, excluding taxes or whose gross assets as reported in the balance sheet, are not less than € 400,000,000; or
- b) that hold, directly or indirectly, at the end of the financial year, more than half of the capital or the voting rights of a legal entity meeting one of the conditions mentioned in a);
- c) whose majority share capital or voting rights of which are held directly or indirectly by a legal entity meeting one of the conditions mentioned in a) at the end of the financial year;
- d) recognised under the worldwide or the consolidated profit system, and those included in the scope of consolidation; or
- e) belonging to a fiscal group where at least one of the companies that make up the fiscal group meets one of the foregoing criteria.

Permanent establishments of foreign companies in France fall within the scope of the documentation obligation to a certain extent (specific appreciation of the criteria mentioned above).

The expression "legal entity" targets any company, organization, trust or comparable institution based or established in France or outside France.

Companies that fall outside the scope of the documentation obligation (following the conditions provided in article L. 13 AA of the FTPC) remain subject to the provisions of article L. 13B of the FTPC.

CHAPTER 2 : CONTENT OF THE DOCUMENTATION OBLIGATION

The documentation obligation targets all types of operations between associated companies. The concept of associated companies corresponds to the concept of related legal entities under the meaning provided by article 39.12 of the FTC.

Following the recommendations of the code of conduct drafted by the Joint Transfer pricing Forum of European Union, the content of the documentation obligation comprises two levels of information: general information regarding the group of associated companies and specific information regarding the associated company undergoing a tax audit.

Additional documentation requirements are provided with regard to the companies conducting transactions with associated companies based or established in non-cooperative countries and territories ("NCCTs").

Pursuant to article L. 123-22 of the French Commercial Code and article 54 of the FTC, the tax authorities may request that the documents drafted in a foreign language are translated in French.

Section 1 : General information regarding the group of associated companies

The company undergoing a tax audit is expected to provide the FTA with the following:

- ✓ a general description of the business activity developed by the group, including the changes that occurred during the audited tax year;
- ✓ an overall description of the legal and operational organization of the group comprising a clear identification of its key member involved in the audited transactions;
- ✓ a global review of the functions performed and the risks borne by the entities involved, insofar as they have an impact on the audited company;
- ✓ a list of the key intangible assets held (e.g. patents, brand names, business names, know-how, etc.) in relation to the company audited; and
- ✓ an overall description of the group's transfer pricing policy.

Section 2 : Specific information on the associated company undergoing a tax audit

This specific information shall include:

- ✓ a description of the business activity, including the changes that occurred during the audited tax year; As far as credit institutions (as defined in article L. 511-1 of the French Monetary and Financial Code) and investment firms (as defined in article L.531-4 of the French Monetary and Financial Code) are concerned, such description shall include, in particular, a presentation of the different business lines and product lines.
- ✓ a description of the operations carried out with other associated companies (comprising the nature of flows and the corresponding amounts, including royalties); As far as credit institutions and investment firms are concerned, such information may be provided by types of transactions or by product or business lines, depending on the credit institution or investment firm's particular structure and organization.
- ✓ a list of cost-sharing agreements and a copy of the APAs on transfer prices and advance tax rulings covering the setting of transfer prices pertaining to the company audited;
- ✓ a description of the selected transfer pricing method(s), comprising an analysis of the functions performed, assets engaged and risks borne as well as a justification of the selection and application of the selected transfer pricing method(s); As far as credit institutions and investment firms are concerned, the documentation may describe the selected transfer pricing methods by types of transactions or by product or business lines.
- ✓ if needed, an analysis of the selected terms of comparison (selected comparables).

Section 3 : Additional documentation requirements when transactions are conducted with associated companies located in based or established in non-cooperative countries and territories ("NCCTs")

Such additional requirements encompass in particular all documents required from companies liable to corporate income tax, including the balance sheet and profit and loss statement established under the conditions provided by articles 102 U and 102 V of Appendix II of the FTC.

The list of NCCTs is fixed by decree signed by the Minister of Economy and the Minister of Budget and updated on January 1st of each year.

CHAPTER 3: TERMS AND CONDITIONS OF IMPLEMENTATION

Section 1 : A documentation based on contemporary elements and updated

The documentation ought to be provided to the tax authorities at the starting date of the tax audit (i.e. at the date of the first operation on the site).

The whole set of documentation must be prepared or updated so as to enable the companies falling under the scope of the documentation obligation to make sure that their transfer prices are compliant with the arm's length principle at the time they fix such prices. In this regard, the comparable searches must prioritize the most recent publicly financial data at the time the considered transactions are invoiced. When the conditions of conducting business remain unchanged, it shall be agreed that the review of comparable searches be updated on a three-year basis.

Section 2: Sending of a formal notice in case of failure to respect the documentation obligation

Where the audited company fails to produce the required documentation or produces an incomplete documentation, the tax authorities send a formal notice to produce or complete it within a thirty-day deadline (that may be extended following a clearly justified request from the taxpayer over an additional period not exceeding a total of two months).

Section 3 : Applicable sanctions

If the audited company falling under the scope of the documentation obligation fails to produce the documentation required or produces incomplete documentation within the thirty-day deadline (or within the extended deadline) upon receipt of a formal notice from the tax authorities, it shall be liable, for each fiscal year subject to tax audit, to a penalty (as stipulated in article 1735 ter of the FTC) amounting to € 10,000 or, where the corresponding amount is higher than the latter amount and depending on the seriousness of the breach, up to 5% of the amount of transferred profits.

The application of the maximum penalty is limited to the cases of complete absence of documentation or incompleteness that deprives the documentation of any relevance.

Besides, a mere disagreement between the taxpayer and the tax authorities about the appropriateness of the selected transfer pricing the method shall not justify the application of the penalty provided by article 1735 ter of the FTC.

The penalty stipulated in article 1735 ter of the FTC is not considered as serious penalty and does not prevent the company from benefiting from the EU Arbitration Convention and Mutual Agreement Procedures.

The provisions of Article L. 189 A of the Tax procedure code pertaining to the suspension of the period needed for assessing taxes in case of mutual agreement procedure based on the double tax treaties or the European convention relating to the elimination of double taxation, shall not be applicable to the above-mentioned penalty. Nevertheless, where the need arises, the penalty shall be reviewed based on the corrections retained upon completion of the mutual agreement procedures or the arbitration proceedings.