CHAMBERS GLOBAL PRACTICE GUIDES

Tax Controversy 2023

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France: Law & Practice
and
France: Trends & Developments

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Baker McKenzie AARPI works as an integrated global team, covering all multi-jurisdictional aspects and effects of an audit or dispute. The firm has more than 250 tax dispute resolution lawyers worldwide (in over 70 offices), offering broad international experience and deep local know-how in concluding disputes through the full range of administrative and legal dispute resolution techniques. The team of tax litigators at Baker McKenzie Paris acts at each stage of a tax controversy, including assistance with tax audit procedures, negotiations with the French tax administration and litigation before domestic and EU jurisdictions.

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1. Tax Controversies

1.1 Tax Controversies in This Jurisdiction

The French tax authorities (FTA) audit the tax returns, the documents used for the establishment of taxes, and supporting documents filed by taxpayers.

An audit may take different forms.

Off-Site Audits (Contrôle Sur Pièces)

Off-site audits consist in carrying out a critical examination of the returns filed by the taxpayer, and aim at:

• checking that all taxpayers have filed their returns;
• correcting errors, deficiencies, inaccuracies, omissions or concealments in the tax basis; and
• with respect to income tax, ensuring that the overall income declared is consistent with the taxpayer’s situation.

Tax Audit

Where the taxpayer is:

• an individual, a contradictory examination of the personal tax situation (examen contradictoire de la situation fiscale personnelle) is initiated, consisting in checking the consistency between the declared income and the assets, cash flow situation and the lifestyle elements of the members of the tax household (Article L. 12 of the French Book of Tax Procedures (Livre des procedures fiscales), the FBTP); and
• a company, an accounting audit (vérification de comptabilité) is initiated involving, beyond a simple examination of the accounts, a comparison of the extra-accounting information with the accounting data on which the declarations are based (Articles L. 13 and R. 13-1 of the FBTP).

Remote Simplified Tax Audit Procedure

When the FTA consider that an accounting audit is not necessary, and provided the taxpayer uses a computerised accounting system to book its accounts, the audit can also take the form of a remote simplified tax audit procedure (examen de comptabilité à distance).

Pursuant to sections L. 13 G and L. 47 AA of the FBTP, the taxpayer is required to provide to the FTA a copy of its “dematerialised accounting files” (fichier des écritures comptables, FEC). The FTA may conduct any sorting operations, and are allowed to request additional information, justifications or clarifications to characterise anomalies detected.

1.2 Causes of Tax Controversies

According to the Key Performance Indicators 2021 (Le Cahier Statistiques 2021) of the General Directorate of Public Finance (DGFIP), the taxes that give rise to the most tax controversies and the values (net values in 2021) involved are:

• VAT and refunds of VAT credits – EUR3,690 billion; and
• corporate income tax – EUR3,078 billion.

1.3 Avoidance of Tax Controversies

Tax controversy can be mitigated by being prepared in advance (ie, by having reviewed the documentation that needs to be made available to the FTA or that could be requested by the tax auditor at any time, for example, transfer pricing documentation, FEC files and documentation supporting transactions, including archives).
1.4 Efforts to Combat Tax Avoidance

EU Measures

Several of the EU’s recent measures were transposed into domestic law to combat tax avoidance.

The Finance Act for 2019 transposed the Anti-Tax Avoidance Directive (ATAD) 2016/1164/EU dated 12 July 2016 on interest limitation rules. It creates a new general mechanism for limiting net financial expenses and provides for specific rules depending on whether or not the company or tax group is thinly capitalised.

The Finance Act for 2020 transposed the Anti-Tax Avoidance (ATAD 2) 2017/952 dated 29 May 2017 in order to prevent French-based entities from deducting expenses related to hybrid arrangements or from taxing – in France – an expense related to a hybrid arrangement that has been deducted abroad (Articles 205 B, 205 C and 205 D of the French Tax Code (FTC) applicable to fiscal years beginning from 1 January 2020).

Moreover, the general anti-abuse clause provided for by the ATAD Directive is transposed into Article 205 A of the FTC, which provides that “in the assessment of corporation tax, no arrangement or series of arrangements shall be taken into account which, having been put in place to obtain, as a main objective or as one of the main objectives, a tax advantage contrary to the object or purpose of the applicable tax law, is/are not authentic in the light of all the relevant facts and circumstances.”

Finally, a specific anti-abuse rule (SAAR) with regard to the exemption of withholding tax on dividends distributed to a European parent is provided for under Article 119 ter of the FTC (resulting from the transposition of the Council Directive 2015/121 of 27 January 2015, which supplemented the Parent-Subsidiary Directive 2011/96 of 30 November 2011).

BEPS Recommendations

France implemented the country-by-country reporting rules, following the release of the OECD/G20 BEPS Action 13 report.

Article 223 quinquies C of the FTC is similar to the provisions of the Directive 2016/881/EU as regards mandatory automatic exchange of information in the field of taxation.

Further to Action 5 of the BEPS project, the French taxation of revenues derived from intellectual property (IP) assets or a “patent box” regime was considered harmful since it was not in line with the so-called “Nexus” approach. Therefore, the 2019 French Finance Act reformed this patent box regime, introducing substantial changes to the scope and conditions of its application (Article 238 of the FTC).

Furthermore, the definition of a permanent establishment (PE) is currently evolving, following the final report of the OECD/G20 BEPS Action 7 on Preventing the Artificial Avoidance of PE Status and depending on the willingness of states to implement this evolution into their double tax treaties (DTTs). On 7 June 2017, France signed the OECD Multilateral Instrument (MLI) and notably opted to include Article 12 of the MLI, which enshrines a new broader PE notion. The application of this broader notion in DTTs, however, depends on the choices made by other signatories (eg, the tax treaty concluded between France and Luxembourg on 20 March 2018 (in force since 1 January 2020) includes such a broader PE notion).
1.5 Additional Tax Assessments
In principle, once tax collection notices have been issued (see 3.1 Administrative Claim Phase), the taxpayer has to pay the tax due before lodging a claim before the FTA (administrative phase). Then, a refund may be granted to the taxpayer if a court invalidates the reassessments.

After having challenged the proposed tax reassessments and during the pre-litigation phase of the procedure, the taxpayer may claim the benefit of the deferral of payment of the tax due until a decision is granted by the court, provided sufficient financial guarantees are given (Article L. 277 of the FBTP).

The FTA, therefore, send the taxpayer a request to enter into or provide guarantees supporting the deferral of payment that was claimed. The provision of guarantees is required for any payment deferral. In the absence of an answer by the taxpayer, the payment deferral could be rejected and the taxpayer would have to pay immediately. The FTA are obliged to examine all the offered guarantees.

Should they consider the proposed guarantees insufficient, the authorities can reject them in a decision that is supported by adequate grounds sent to the taxpayer. This decision can be challenged, however, before a tax judge within a period of 15 days as of the receipt of the letter from the Treasury Accountant (Comptable du Trésor Public), informing the taxpayer of the refusal of the proposed guarantees. The tax judge will only take a position on the guarantees proposed by the taxpayer and will not hand down a decision on the merits of the reassessments.

If the taxpayer obtains the payment deferral, and if the lower tax court rejects its claim, the taxpayer will have to pay the reassessed tax, late payment fees and penalties, and additional late payment interest. Conversely, the taxpayer will be entitled to a refund of the guarantee fees. If the taxpayer decides to pay immediately after the receipt of the tax collection notice, and if the lower tax court upholds the right to its claims, it will be entitled to a refund of the sums paid, plus late payment interest.

**Tax Penalties and Fines**
Tax penalties apply if the taxpayer fails to declare and/or pay the tax in due time. The sanctions for failing to file declarations correctly, pay taxes or fulfil other tax obligations can be divided into two broad categories:

- late payment interest and tax fines applied by the FTA which are subject to appeal before the administrative courts; and
- criminal penalties imposed by criminal courts.

**Fines**
In principle, late payment interest of 0.2% per month is due on all late payment of taxes (Article 1727 of the FTC) caused by the late filing of tax returns and other assessment documents, under-payments (errors or omissions) and simple late payments. This late payment interest is not capped and its starting point depends on the taxes adjusted.

The late payment interest may be reduced in certain circumstances, notably depending on the behaviour of the taxpayer.

The FTC also provides for a specific penalty for the failure to file declarations and documents or the failure to file these on time (10% when the late declaration is filed by the taxpayer prior to any notice of the French tax authorities or within 30 days after an initial official notice (mise en
demeur); 40% if the declaration or information document is not sent to the FTA within 30 days after the official notice; or 80% in the event of concealed activity).

Other tax penalties are applicable – eg, in the case of a deliberate breach (amounting to 40%), abuse of law (amounting either to 40 or 80%), fraudulent behaviour (amounting to 80%) or refusal to co-operate during a tax audit (amounting to 100%).

Criminal penalties
The general offence of tax fraud is broadly defined by Article 1741 of the FTC and is punishable, regardless of the applicable tax penalties, by five years’ imprisonment and a fine of EUR500,000, which may be increased to an amount equal to twice the proceeds of the offence (note that the level of penalties can be increased up to five times the above-mentioned amount for legal entities, which could represent EUR2.5 million or ten times the proceeds of the offence).

The penalties are increased where the acts were committed by an organised group or under specified circumstances.

The level of these maximum penalties may be lowered by a judge.

2. Tax Audits

2.1 Main Rules Determining Tax Audits
In France, enterprises are audited on a discretionary basis and, consequently, some entities are more likely than others to be subject to tax audits (eg, large companies are audited about once every three years). The FTA may use databases to identify and follow companies that need to be audited regularly or apply a method using different ratios, taking into account the turnover declared, inventories, purchases, labour costs, purchase of assets, debts, income and booked reserves, and depreciation allowances.

Furthermore, the local tax authorities (Service des Impôts) monitor the consistency of tax returns and look for errors in order to propose tax audits. Specific tax departments, such as the National Directorate of Tax Investigations (Direction Nationale des Enquêtes Fiscales), process information (press, derogatory procedures, etc) per activity and sector.

The General Directorate of Public Finance has a tax policy that is dependent on strategic sectors and also looks for specific frauds (eg, intra-community VAT, new business and R&D tax credit).

2.2 Initiation and Duration of a Tax Audit
There is no specific time limit within which the tax audit must be initiated, even though in practice, tax authorities are limited by the statute of limitations.

The FTA can only exercise their authority to audit and reassess within three calendar years following the year during which the taxable event occurred (Article L. 169 of the FBTP).

There are several exceptions to this general rule (eg, the statute of limitations is extended to ten years in the event of a concealed activity or when French-controlled foreign companies rules are involved).

Moreover, the FTA may audit the origin of tax losses generated during a statute-barred year, which are carried over to a year that is still open to tax audit, and reassess them.
The statute of limitations is interrupted by:

- either a reassessment notice or by any other declarations or notifications of minutes;
- any act involving recognition of the parties liable for payment (payment of a deposit, request for an additional time limit, request for a penalties discount, precise accounting records, etc); or
- any other commonplace law-interrupting acts (legal proceedings, enforcement actions).

2.3 Location and Procedure of Tax Audits
Where the taxpayer is an individual, the tax audit takes place, in principle, within the FTA’s premises.

Where the taxpayer is an entity, the tax audit generally takes the form of an on-site tax audit (verification de comptabilité), in principle, within the premises of the company or, under certain circumstances takes the form of a remote simplified tax audit procedure (examen de comptabilité à distance).

To obtain more information than is provided by the taxpayer, the FTA also have, notably:

- a right of communication (Article L. 81 of the FBTP) allowing them to ask a third party, or the taxpayer itself, for information in its possession, or to examine certain documents; and
- a right to visit and seize (Article L. 16 B of the FBTP) in order to investigate offences relating to direct taxes and turnover taxes, subject to an authorisation given by a judge when there is a presumption of tax fraud.

2.4 Areas of Special Attention in Tax Audits
Key areas and matters for tax auditors’ special attention are transfer pricing and questions of PE.

Transfer pricing issues are sensitive issues and need specific attention with increased challenges to the functional profile of French entities and the application of the profit split method.

There have been numerous permanent establishment assessments made by the FTA over the last few years. In the Conversant case, dated 11 December 2020, the French Supreme Administrative Court set out principles that broadly interpret treaty provisions of permanent establishment and take an innovative approach to European Union law regarding the characterisation of fixed establishment for VAT purposes. These cases are highly dependent on a case-by-case factual analysis.

The FTA also pay special attention to matters such as business restructurings, substance matters, VAT, withholding tax, employee benefits and R&D tax credits.

2.5 Impact of Rules Concerning Cross-Border Exchanges of Information and Mutual Assistance Between Tax Authorities on Tax Audits
As part of the BEPS project, Article 223 quinquies C of the FTC introduced country-by-country declaration of economic, accounting and tax results that must be remotely declared by certain companies in order to combat tax optimisation and tax evasion.

Moreover, Article L. 114 of the FBTP allows the FTA to communicate any information concerning direct or indirect taxes upon the request of
another EU member state, as long as the FTA have reciprocal treatment in that state.

Furthermore, Article L. 45 of the FBTP provides that the FTA can agree with another member state to initiate simultaneous audits. Information gathered during the course of these audits will be exchanged between the different tax authorities.

Article L. 45 of the FBTP also provides for the possibility of initiating joint tax audits even if this still remains rare in France.

2.6 Strategic Points for Consideration During Tax Audits

It is advisable to engage in continual discussions with the tax auditor to be able to understand their potential concerns since the procedure must be adversarial.

Following the receipt of a tax reassessment notice, it is generally recommended to develop all the arguments that may be relevant in the taxpayer’s response.

During the entire procedure, the main issue is to determine whether the taxpayer should try to enter into a settlement agreement with the FTA or move forward with litigation. This will mainly depend on the arguments of the FTA and the nature of the reassessment, but it is recommended to challenge all the reassessments and determine the chance of success of the taxpayer’s positions.

In the event of disagreement, the taxpayer has the right to appeal to the Departmental Interlocutor (Interlocuteur Départemental), who is one of the heads of the FTA’s service in charge of tax audits.

In certain circumstances, the dispute may be submitted for an opinion to the Departmental Committee on direct taxes and turnover taxes at the request of one or other of the parties.

3. Administrative Litigation

3.1 Administrative Claim Phase

The administrative claim phase begins with the implementation of either the adversarial adjustment procedure or the unilateral reassessment procedure. At the end of these procedures, a tax collection notice is sent to the taxpayer, which allows it to file a tax claim before the FTA to request the withdrawal of the reassessments.

If the FTA determine, after an audit, that the taxpayer’s tax return contains a deficiency, omission or concealment, or is inaccurate upon comparison with the latter’s taxable income or transactions, they may initiate a contradictory reassessment procedure (procédure de rectification contradictoire) by sending a tax reassessment notice to the taxpayer (Article L. 55 of the FBTP). A tax reassessment notice, notably, must set forth the amount of the proposed reassessment, the reasons justifying it, and the tax consequences of such a reassessment (Articles L. 57 and L. 48 of the FBTP).

Within 30 days from the date of receipt of the tax reassessment notice (which can be extended to 60 days at the taxpayer’s request), the taxpayer must either accept the proposed reassessment or submit a response challenging the reassessment (observations du contribuable) (Article R. 57-1 of the FBTP).

If the taxpayer accepts this reassessment, or fails to respond, it is not barred from challenging the reassessment but the burden of proof will
shift from the FTA to the taxpayer. If the taxpayer refuses the reassessment and files a response, the FTA may thereupon either drop, confirm or modify the proposed reassessment (Article L. 57 of the FBTP) by way of an answer to the taxpayer's comments (réponse aux observations du contribuable).

In this respect, the FTA have an obligation to respond to the observations of the taxpayer within 60 days (concerning industrial and commercial companies whose turnover does not exceed EUR1.526 million, and companies with a non-commercial activity whose turnover does not exceed EUR460,000) (Article L. 57 A of the FBTP). Otherwise, the FTA will be deemed to have accepted the observations of the taxpayer. After this notice has been sent by the FTA, the taxpayer may resort to administrative appeals.

Both the FTA and the taxpayer have the right, under certain conditions, to submit the matter to the Commission for direct taxes and turnover taxes (Commission des impôts directs et des taxes sur le chiffre d'affaires) or the Departmental Conciliation Committee (Commission Départementale de conciliation) within 30 days (Article L. 59 of the FBTP). These bodies will issue a non-binding opinion on questions of fact, not of law.

After the final letter of the FTA, and in the absence of recourse to the Commission, the FTA are entitled to issue a tax collection notice requiring the taxpayer to pay the tax due (avis de mise en recouvrement).

In certain instances, the FTA can reassess the taxpayer's income (Article L. 65 of the FBTP) unilaterally (eg, where the taxpayer failed to file a tax return in due time, and fails to do so within 30 days of its receipt of a notice sent to that effect by the FTA (Articles L. 67 and L. 68 of the FBTP)).

3.2 Deadline for Administrative Claims
The time period within which the taxpayer can file a claim would generally expire on 31st December of the second year following the year of the receipt of the tax collection notice or the payment of the tax.

The FTA will review the claim and have the right to change the stated legal basis for the reassessment, as well as reduce or cancel the reassessment.

It is only upon a response by the FTA to such a claim that the case can be brought to court. A lack of response from the FTA after a six-month period allows the action to be initiated with the court.

4. Judicial Litigation: First Instance
4.1 Initiation of Judicial Tax Litigation
Judicial tax litigation is initiated by the means of an introductory brief (requête introductive d’instance) before the administrative court or a subpoena to initiate proceedings (assignation) before the civil court.

The competent jurisdiction depends on the nature of the tax in dispute and will depend geographically on the jurisdiction in which the branch of the FTA in charge of the collection of the tax is located.

4.2 Procedure of Judicial Tax Litigation
Appeals against administrative tax decisions will be heard either before the lower civil courts (for stamp duties, indirect contributions, taxes on real estate and wealth tax) or before the lower administrative courts (for direct taxes and turnover taxes).
4.3 Relevance of Evidence in Judicial Tax Litigation
Before lower courts, the parties' claims and arguments are set out in written conclusions. Pleadings must only refer to those claims already raised in written conclusions.

4.4 Burden of Proof in Judicial Tax Litigation
Before the tax court, the question of burden of proof depends on the reassessment procedure. In principle, the FTA bear the burden of proof when they intend to reassess the tax base of a taxpayer; for some procedures, such as the ex officio procedure, the burden may be passed to the taxpayer.

Before the criminal courts, the burden of proof lies in all cases with the Public Prosecutor's Office, to which the tax authorities may be added as a civil party.

4.5 Strategic Options in Judicial Tax Litigation
The strategic options to consider during tax litigation depend on the factual and legal background of the case and should be assessed on a case-by-case basis.

4.6 Relevance of Jurisprudence and Guidelines to Judicial Tax Litigation
In addition to domestic case law, French courts take into consideration case law from the European Court of Justice and the European Court of Human Rights.

The FTA's doctrines (official published guidelines and individual decisions) are also enforceable in cases of tax reassessment. Article L. 80 A of the FBTP prohibits tax authorities from raising taxes that would be inconsistent with the administrative doctrine in force at the time they were applied, either by the FTA or by the taxpayer.

Finally, in the Conversant case dated 11 December 2020, the Supreme Administrative Court expressly referred to interpretative commentaries issued after the entry into force of the treaty concluded between France and Ireland.

5. Judicial Litigation: Appeals

5.1 System for Appealing Judicial Tax Litigation
Judgments of lower courts may be appealed to the Court of Appeal (Cour d’appel) within whose jurisdiction the lower court is located.

The deadline to file such an appeal depends on the appealing party (the taxpayer or FTA) and whether the first instance decision was rendered by an administrative or a civil lower court.

Judgments of appellate courts can be appealed before the supreme courts – the Supreme Administrative Court (Conseil d’Etat) or the Supreme Civil Court (Cour de Cassation).

5.2 Stages in the Tax Appeal Procedure
The parties' claims and arguments are set out in written conclusions.

Depending on the competent jurisdiction, deadlines to file written conclusions may be binding.

5.3 Judges and Decisions in Tax Appeals
The composition of the court depends on the nature of the litigation and the complexity of the case.
6. Alternative Dispute Resolution (ADR) Mechanisms

6.1 Mechanisms for Tax-Related ADR in This Jurisdiction

Alternative dispute resolution (ADR) mechanisms such as mutual agreement procedures (MAPs) may be used to resolve situations of double taxation that are caused by transfer pricing or permanent establishment reassessments.

For transfer pricing matters resulting in double taxation, a MAP can also be initiated under the European arbitration convention. The opening of both procedures can be requested in parallel.

French Tax Treaties

The French competent authorities may refuse to open a MAP under certain circumstances. Depending on the applicable bilateral tax treaty, the deadline to request the opening of a MAP ranges from three months to three years from the measure that leads to double taxation. In some bilateral tax treaties, no deadline is specified. In practice, it is generally recommended that the opening of a MAP be requested soon after the administrative appeals have been exhausted, it being specified that it does not suspend the issuance of tax collection notices and that the competent authorities are not obliged to reach an agreement.

In addition, a few tax treaties concluded by France include an arbitration clause, consistent with Article 25 (5) of the OECD Model Tax Convention. The MLI has included provisions for arbitration which were generally adopted by France (with some reservations) when submitting its instrument of ratification on 27 September 2018 (applicable since 1 January 2019).

European Arbitration Convention

At the European level, the European arbitration convention allows the reaching of an agreement on transfer pricing matters resulting in double taxation within – in theory – a two-year deadline. Otherwise, an arbitration phase should be opened, subject to the taxpayer’s agreement. In practice, very few cases have reached this phase despite the fact that a significant number of MAP cases have not been resolved within the two-year timeframe.

Furthermore, the EU Directive 2017/1852 on tax dispute resolution mechanisms in the EU has introduced a more co-ordinated EU approach to ensure that disputes related to the interpretation of tax treaties or double taxation problems can be resolved more swiftly and effectively (transposed at Article L. 251 B and subsequent of the FBTP).

6.2 Settlement of Tax Disputes by Means of ADR

As regards MAPs and arbitration procedures, please refer to 6.1 Mechanisms for Tax-Related ADR in This Jurisdiction.

According to Article L. 247 of the FBTP, tax settlements are only possible in regard to tax penalties.

However, another procedure – a global settlement (règlement d’ensemble) – may also be made as part of a tax audit of a company, enabling the company to reach an agreement with the tax authorities on the amount of taxes and penalties due.
6.3 Agreements to Reduce Tax Assessments, Interest or Penalties
Please refer to 6.1 Mechanisms for Tax-Related ADR in this Jurisdiction and 6.2 Settlement of Tax Disputes by Means of ADR.

6.4 Avoiding Disputes by Means of Binding Advance Information and Ruling Requests
There are different kinds of rulings under French law:

• “special rulings”, exhaustively listed in Article L. 80 B, No 2 et seq of the FBTP, including for instance, a “no permanent establishment (no-PE) ruling” under which a taxpayer asks the FTA whether it has a permanent establishment in France; and

• “general rulings” (Article L. 80 B, No 1 of the FBTP) under which a taxpayer asks the FTA to draw the legal consequences of a given factual situation.

In both cases, the ruling shall clearly outline the technical analysis of the applicant and a precise, complete and sincere presentation of the factual situation (ie, complete disclosure of the facts).

It should be noted that:

• regarding no-PE rulings, the FTA has three months as from the receipt of the application to provide its position – the reply or absence of a reply is binding vis-à-vis the FTA;

• regarding general rulings, the FTA has also three months as from the receipt of the application to provide its position – in the case of a reply, this position is binding vis-à-vis the FTA but unlike in the case of a special ruling, the absence of a reply to a general ruling within this deadline has no consequences vis-à-vis the FTA; and

• it is possible to file a ruling on a “no-name basis” but the response of the FTA (if any) would not be binding.

The information disclosed through a ruling application should remain confidential.

6.5 Further Particulars Concerning Tax ADR Mechanisms
Tax settlements cover all kinds of situations (ie, all taxes and penalties, except where a settlement would be based on Article L. 247 of the FBTP, which only covers the amount of penalties) and can be reached at any time of the procedure (including where a litigation is ongoing) with no specific deadline applicable, even though they are generally reached before the issuance of the tax collection notice. In France, tax settlements are generally definitive and not subject to appeal or any other recourse.

MAPs cover economic or legal double taxation and specific deadlines are applicable (see 6.1 Mechanisms for Tax-Related ADR in This Jurisdiction).

6.6 Use of ADR in Transfer Pricing and Cases of Indirect Determination of Tax ADR mechanisms can be used to settle disputes over transfer pricing cases, since they could lead to double taxation (in this respect, see 6.1 Mechanisms for Tax-Related ADR in This Jurisdiction). Transfer pricing cases or cases where taxes are determined by indirect methods may also be settled by a global settlement.
7. Administrative and Criminal Tax Offences

7.1 Interaction of Tax Assessments With Tax Infringements

When characterised presumptions of tax fraud exist, the public prosecutor is only allowed to prosecute the offence of tax fraud in cases where the FTA lodge a criminal complaint.

In addition to the possibility of the FTA filing complaints for tax fraud (only after getting a favourable binding opinion of the committee on tax offences in cases of non-aggravated tax fraud), Law No 2018-898 on the fight against fraud, dated 23 October 2018, provides that the FTA are compelled to report facts to the public prosecutor where these facts lead to the following.

- A tax reassessment exceeding an amount of EUR100,000; and
- The application (in a tax collection notice) of:
  (a) the 100% penalty (ex officio procedure);
  (b) the 80% penalties (eg, for concealed activity or fraudulent behaviour); or
  (c) the 40% penalties (late submission of a tax return or deliberate breach), where the taxpayer has been subject:
    (i) to the penalties listed at a), b) or c) in the context of a previous tax audit during the last six calendar years; or
    (ii) to a complaint of the French tax authorities further to a previous tax audit.

Once the facts have been reported, the public prosecutor is entitled to prosecute for the offence of tax fraud.

If the FTA has filed a criminal complaint for tax fraud regarding a taxpayer, the public prosecutor can extend criminal charges to other taxes and other years without the need for a further criminal complaint or reporting for those years from the FTA.

Once the complaint has been filed or the facts have been reported, judicial investigation can be, under the judicial authorities’ control, conducted by tax agents benefiting from judicial powers.

The offence of money laundering of tax fraud can be prosecuted by the public prosecutor on their own initiative.

7.2 Relationship Between Administrative and Criminal Processes

Administrative courts are not bound by the decisions of judicial courts in criminal matters, and vice versa, by virtue of the principle of independence of tax and criminal proceedings. Judicial courts are thus not required to stay the proceedings and await the decision of administrative courts, nor are they bound by the latter’s decisions, which means that they can find taxpayers guilty of tax fraud even if the Supreme Administrative Court has recognised that the reassessments which justified the criminal proceedings for tax fraud were not grounded, as long as the criminal judge characterises the same facts in a different manner.

However, there are limits to this principle of procedural independence.

Firstly, the administrative judge is bound by the material findings of facts by the criminal judge, and by their legal characterisation for criminal law purposes, upon two conditions.

First, that these findings of facts are made in a final judgment on the merits (ie, a judgment that has the force of res judicata). Conversely, the
administrative judge is not bound by a decision to dismiss proceedings (ordonnance de non-lieu) or by a referral order (ordonnance de renvoi) by the investigating judge (juge d'instruction).

Second, that these findings of facts constitute the necessary grounds of the decision of the criminal judge. Conversely, the administrative judge is not bound by the findings of facts that do not motivate the decision of the criminal judge (Supreme Administrative Court 14 Dec 1984, No 37200). Therefore, where a decision of acquittal is rendered by a criminal court, the administrative court is required, before making its own assessment regarding the materiality and characterisation of the facts for tax law purposes, to determine whether this acquittal was based on findings of fact which are binding on it.

If these conditions are met, the facts found by the criminal judge are deemed materially established, and the taxpayer is not entitled to challenge their accuracy before the administrative judge.

Finally, and conversely, the criminal judge may, without disregarding their jurisdiction or breaching the above-mentioned principle of procedural independence, justify their decision to acquit in view, among other things, of the decisions handed down by administrative courts to discharge the taxpayer.

In several decisions, the Constitutional Court has ruled that the cumulative application of tax and criminal penalties was in compliance with Article 8 of the Declaration of the Rights of Man and of the Citizen, but has expressed interpretative reservations according to which it is applicable if certain conditions are met.

7.3 Initiation of Administrative Processes and Criminal Cases

The general offence of tax fraud is broadly defined by Article 1741 of the FTC.

Theoretically, all tax adjustments may lead to criminal prosecution.

Except for the rules under which the tax authorities are compelled to report facts to the public prosecutor, the prosecution of the offence of tax fraud is at the sole discretion of the FTA.

7.4 Stages of Administrative Processes and Criminal Cases

Preliminary Investigations

Once a complaint has been filed by the FTA (or facts have been reported to the public prosecutor by the FTA) and if the public prosecutor decides to investigate the case, several investigative acts may be performed by police officers or directly by the public prosecutor in the preliminary investigation.

If the public prosecutor considers that the preliminary investigation is sufficient, they may decide to bring the case before criminal courts (the tax court being not competent to hear tax criminal cases).

Judicial Investigations

If the Public Prosecutor considers that the preliminary investigation did not uncover all the circumstances surrounding the commission of a criminal offence, thus preventing its immediate criminal prosecution, they may decide to appoint an investigating judge tasked with further investigating that criminal offence during a so-called judicial investigation. At the end of the judicial investigation, the investigating judge may determine either that there are insufficient grounds to bring the case to court, resulting in a dismissal.
order, or that there are sufficient grounds for a person to stand trial. In this case, the judge shall issue a specific committal order outlining the charges with a view to referring the case to the criminal court with jurisdiction to try the offence.

7.5 Possibility of Fine Reductions
There is no rule under which a taxpayer can benefit from reductions of fines applicable to the corresponding tax offence where upfront payment of the additional tax assessment is made.

The criminal judge may, however, take this element into account to reduce the amount of the fine provided by criminal law.

7.6 Possibility of Agreements to Prevent Trial
Paying the tax assessed, plus interest and penalties, cannot prevent or stop a criminal tax trial. However, two criminal settlement proceedings could potentially be envisaged under French law (both applicable for the offences of tax fraud and the money laundering of tax fraud).

The CRPC
A settlement close to plea bargaining agreements is referred to as comparution sur reconnaissances préalable de culpabilité (CRPC). The CRPC requires that the defendant pleads guilty to the charges and applies to both individuals and companies but only for certain offences. Once the public prosecutor and the defendant reach an agreement, the defendant is brought before the president of the first instance tribunal.

The CJIP
A settlement close to a deferred prosecution agreement (Convention Judiciaire d’intérêt Public, CJIP) allows entities (ie, not individuals) to avoid a criminal conviction by:

- paying a fine proportionate to the gains derived from the company’s wrongdoing, which cannot exceed 30% of the company’s annual turnover in total; and
- implementing a compliance monitorship for a period up to three years.

Unlike with the CRPC, the defendant is not required to plead guilty to the charges. The CJIP must be approved by a judge, and if so, the prosecution office issues a press release and the approval order issued by the judge is published on the new National Anti-Corruption Agency’s website.

7.7 Appeals Against Criminal Tax Decisions
It is possible to appeal before the competent appellate court against a decision adopted by a court of first instance that decided on the criminal tax offence in question. The court of appeal has the ability to re-examine the entire case. The appeal has a suspensive effect.

7.8 Rules Challenging Transactions and Operations in This Jurisdiction
Rules challenging transactions and operations, notably under general anti-abuse rules (GAAR) or under transfer pricing rules, could give rise to criminal tax cases, even though until now the majority of criminal tax cases have been related to VAT fraud.

8. Cross-Border Tax Disputes

8.1 Mechanisms to Deal With Double Taxation
In the event that a double taxation situation occurs due to a tax adjustment performed by the FTA, it is common to use both domestic litigation to challenge the position of the FTA and
the available mechanism under the double tax treaty (eg, the MAP or an arbitration), it being noted that domestic litigation is often a prerequisite to challenge instances of double taxation. The impact of the MLI and the EU Tax Disputes Directive 2017/1852 remains limited from a tax dispute perspective given their recent adoption.

8.2 Application of GAAR/SAAR to Cross-Border Situations

In France, general anti-abuse rules (GAAR) and specific anti-abuse rules (SAAR) apply to cross-border situations covered by bilateral tax treaties.

**GAAR**

Article L. 64 of the FBTP, which is comparable to the principal purpose test (PPT) introduced by the MLI, provides for an abuse of law procedure that allows the FTA to dismiss, as not enforceable against it, the acts constituting an abuse of law. In the Verdannet case, dated 26 October 2017, the Supreme Administrative Court ruled that the FTA may apply Article L. 64 of the FBTP to prevent the application of a tax treaty even if the latter does not contain a specific clause regarding abuse of law. The Supreme Administrative Court further added, in line with DTT preambles as amended by the MLI, that situations arising from artificial arrangements devoid of any economic substance are necessarily contrary to the purpose of DTTs.

In addition, acts committed or carried out, from 1 January 2020, may henceforth be excluded by tax authorities in the case of an abuse of law, on the grounds that their main purpose is tax avoidance (L. 64 A of the FBTP).

In terms of corporate income tax, a general anti-abuse clause derived from the ATAD Directive has been transposed into Article 205 A of the FTC (in this respect, see 1.4 Efforts to Combat Tax Avoidance).

**SAAR**

Various specific anti-abuse rules are also provided for under French legislation and specifically cover abuses of law allowed by cross-border situations.

8.3 Challenges to International Transfer Pricing Adjustments

The transfer pricing method used by a company could be challenged by the FTA based on both domestic provisions and double tax treaty provisions. Article 57 of the FTC allows the FTA to adjust the profits of a French enterprise in the event that the latter has indirectly transferred profits to a foreign-associated enterprise by an increase or decrease in purchase or sale prices, or by any other means. The arm’s length principle is also set out in Article 9 of the OECD Model Tax Convention.

8.4 Unilateral/Bilateral Advance Pricing Agreements

Multinational enterprises can request unilateral or bilateral (potentially multilateral) advance pricing agreements (APAs) from the FTA to reach an agreement on the determination of a transfer pricing method over a given period of time for future related-party transactions, and so avoid future litigation over transfer pricing matters.

The FTA has expressed a preference for bilateral APAs.

Unilateral APAs are notably available in the following cases:
• where there is no available APA programme in the other state; or
• if the transactions relate to a specific problem, which is not complex but gives rise to recurrent disputes, such as invoicing general expenses within a group.

No unilateral APA is granted for transactions with enterprises situated in countries that do not have a treaty with France and have a privileged tax regime (as defined in Article 238 A of the FTC).

In an APA, the FTA agrees on the method, not on the price itself. An APA can be requested for all the transactions between a French enterprise and its associated foreign enterprise, or dealings between a permanent establishment and the rest of the enterprise to which it belongs. Alternatively, an APA can be requested – subject to the FTA agreeing that such a restricted scope is acceptable – for a segment of the enterprise’s activities only, a type of transaction, a function or a product.

8.5 Litigation Relating to Cross-Border Situations
The key areas and matters for tax auditors’ special attention are transfer pricing, withholding tax, permanent establishment as well as substance questions. These questions therefore generate the most litigation on cross-border situations.

Considering the Conversant case on PE as well as recent cases on the application of the profit split method, specific attention should be paid to the functions, assets and risks of each group company involved in the value chain.

9. State Aid Disputes

9.1 State Aid Disputes Involving Taxes
France has been involved in two types of state aid disputes involving taxes: disputes relating to tax measures constituting unlawful or incompatible state aid and disputes relating to taxes financing a state aid measure.

Disputes Relating to Tax Measures Constituting Unlawful or Incompatible State Aid
The French aid scheme for depreciation granted to economic interest groups has been qualified by the European Commission as unlawful and incompatible aid (European Commission, decision No 2007/256/EC dated 20 December 2006).

It is also possible to mention the dispute involving the French company Electricité de France, which, according to the European Commission, benefited from an unlawful and incompatible aid in the form of an exemption from corporate income tax (European Commission, decision No 2005/145/EC dated 16 December 2003; European Commission, decision No (EU) 2016/154 dated 22 July 2015).

Disputes Relating to Taxes Financing a State Aid Measure
If a state aid regime does not comply with EU law and if the taxes financing that regime are qualified as an integral part of the regime, taxpayers are entitled to claim for a refund of the taxes paid.

The trend in recent years has been rather unfavourable to taxpayers insofar as it is frequently judged that the criterion of hypothecation between the tax and the aid scheme is not met (eg, Supreme Administrative Court, 12 April 2019, No 376193).
9.2 Procedures Used to Recover Unlawful/Incompatible Fiscal State Aid
French national law does not provide for any specific procedure for the recovery of incompatible or unlawful state aid. The Supreme Administrative Court has consistently ruled that the regime for the recovery of state aid is entirely governed by the provisions of Council Regulation No (EU) 2015/1589 dated 13 July 2015.

9.3 Challenges by Taxpayers
Instances of taxpayers challenging requests or additional tax assessments to recover unlawful/incompatible fiscal state aid are very limited. For example, in the case concerning Électricité de France (see 9.1 State Aid Disputes Involving Taxes), the latter challenged the request for recovery of illegal and incompatible aid that it had received.

9.4 Refunds Invoking Extra-Contractual Civil Liability
In a case dated 7 June 2017 (No 386627), the Supreme Administrative Court ruled that a taxpayer cannot obtain compensation on the grounds that France would be liable for the unlawful fiscal state aid it granted.

10. International Tax Arbitration Options and Procedures

10.1 Application of Part VI of the Multilateral Instrument (MLI) to Covered Tax Agreements (CTAs)
In accordance with Article 18 of the MLI, France has elected to apply Part VI.

10.2 Types of Matters That Can Be Submitted to Arbitration
France did not make reservations on the principle of applying the arbitration mechanism provided for by the BEPS measures implemented through the MLI. Arbitration clauses, although not often used by France in the past, should be applied more widely in the future, subject to the reservations made by the other signatory states of the MLI.

France has made, however, some reservations regarding the type of case that it may exclude from arbitration. These include:

- cases where elements of income or wealth are not taxed by a contracting jurisdiction;
- cases where a taxpayer is subject to an administrative or criminal sanction for tax fraud, deliberate omission, or serious breach of a filing obligation;
- cases that can be submitted to an arbitration procedure provided for by EU laws or regulations;
- cases in which the average taxable amount per fiscal year or per calendar year is less than EUR150,000; and
- cases for which a common agreement with the competent authority of the other state has been reached.

EU Arbitration
At the EU level, the possibility to use arbitration is based on the EU Convention (90/436/CEE), which is, however, limited to transfer pricing issues between related companies. Access to the EU Convention may be denied in case of application of severe penalties.

As of 1 July 2019, the EU Directive 2017/1852 on tax dispute resolution mechanisms (transposed in articles L. 251 B and seq of the FBTP) applies...
to disputes between the FTA and the authorities of other EU member states arising from the interpretation and application of DTTs concluded between France and one or more EU member states, and resulting in taxation not in accordance with the applicable treaties.

However, such a procedure cannot be applied in the case of a definitive application of a 40% penalty for deliberate breach or an 80% penalty for abuse of law, or if a definitive court decision has confirmed the taxation. Articulation with litigation could raise practical issues. For further details regarding arbitration procedure, please refer to 6.1 Mechanisms for Tax-Related ADR in this Jurisdiction.

10.3 Application of the Baseball Arbitration or the Independent Opinion Procedure
Further to the implementation of the MLI in tax treaties concluded by France, the baseball arbitration method should now prevail over the independent opinion arbitration method, subject to the agreement of both parties.

In the context of the EU Directive 2017/1852, baseball arbitration shall be considered as an alternative dispute resolution mechanism at the disposal of the French competent authority. French law grants the competent authority the right to constitute an alternative dispute resolution commission with the other competent authority(ies) concerned so as to apply another decision-making process. This could lead to the application of baseball arbitration.

10.4 Implementation of the EU Directive on Arbitration
See 10.2 Types of Matters that Can Be Submitted to Arbitration.

10.5 Existing Use of Recent International and EU Legal Instruments
Recent international and EU legal instruments are often used in France. With the MLI and the EU Directive 2017/1852, more cases have become eligible for arbitration proceedings and such proceedings should therefore increase in the coming years.

10.6 New Procedures for New Developments Under Pillar One and Two
With respect to Pillar Two, the Council of the European Union adopted Directive (EU) 2022/2523, which broadly adopts the principles developed by the OECD/G20. Member States will have to transpose the rules into domestic law by 31 December 2023. With respect to Pillar One, Bruno Le Maire, French Minister of the Economy and Finance stated in February 2023 that, while Pillar Two could be implemented in France within a few months, the future of Pillar One was more uncertain given the recent discussions at the OECD/G20 level. He specified that, in case of blockage at the international level, he would plead for its implementation at the European level.

Pillar One provides for mandatory and binding dispute prevention and resolution mechanisms to deal with any risk of double taxation. With respect to Pillar Two, the OECD released on 20 December 2022 a public consultation guidance document to outline various mechanisms for achieving tax certainty under the GloBE rules.

As a general matter, these mechanisms may not be sufficient due to the complexity of the envisaged instruments.

10.7 Publication of Decisions
In principle, information given and received during arbitration is treated as confidential. A breach
of confidentiality may end the procedure. The EU Directive 2017/1852 provides for the possibility to publish final decisions under certain conditions subject to the consent of each of the persons concerned.

10.8 Most Common Legal Instruments to Settle Tax Disputes
Taxpayers may choose the most suitable tool depending on the matter at stake (e.g., transfer pricing or other cases). A large range of tools may be used in France:

- DTTs that include an arbitration clause (e.g., the DTT with the USA);
- DTTs impacted by the MLI;
- the EU Dispute Resolution Directive and the domestic rules that implemented it; or
- the EU Arbitration Convention.

10.9 Involvements of Lawyers, Barristers and Practitioners in International Tax Arbitration to Settle Tax Disputes
Each member of the arbitration commission shall be independent from people directly involved in the case and is designated by the competent authorities.

In principle, taxpayers are allowed to hire independent professionals to represent them during the arbitration proceedings.

11. Costs/Fees

11.1 Costs/Fees Relating to Administrative Litigation
No costs are required to litigate at the administrative level.

11.2 Judicial Court Fees
Trial costs can be divided into two categories: ordinary expenses and “irrecoverable” costs (frais irrépétibles).

Regarding ordinary expenses, when the claimant is successful, in whole or in part, the costs of service are refunded to them.

With regard to irrecoverable costs, in all proceedings, the judge shall order the party liable to pay the above-mentioned expenses or, failing that, the losing party to pay the other party the amount they determine, for the costs incurred and not included in the ordinary expenses (e.g., lawyers’ fees).

In tax matters, taxpayers who obtain a favourable judgment from a lower court may be reimbursed for the costs of guarantees provided in order to benefit from the payment deferral or may obtain late payment interest in cases where they paid the tax adjustments instead of requesting the benefit of the payment deferral.

However, taxpayers who obtain a payment deferral further to the filing of a tax claim must pay late interest to the state if the court issues an unfavourable decision against them or if they withdraw from the dispute.

11.3 Indemnities
No indemnities are provided for within French legislation if the court decides that the initial additional tax assessment is absolutely null and void.

However, it is possible in certain circumstances to bring an action for damages against the FTA in order to obtain indemnities.
11.4 Costs of ADR
There are no court fees applicable if a taxpayer opts to use any of the ADR mechanisms.

12. Statistics

12.1 Pending Tax Court Cases
According to the Key Performance Indicators 2021 (Le Cahier Statistiques 2021) of the General Directorate of Public Finance, the number of pending tax court cases in 2021 are as follows.

Administrative Courts
• Before the Lower Administrative Court: 11,728.
• Before the Administrative Court of Appeal: 2,582.
• Before the Supreme Administrative Court: 426.

Civil Courts
• Before the Lower Civil Court: 619.
• Before the Civil Court of Appeal: 311.
• Before the Supreme Court: 76.

12.2 Cases Relating to Different Taxes
According to the Key Performance Indicators 2021 (Le Cahier Statistiques 2021) of the General Directorate of Public Finance, statistics with regard to the number of terminated tax claims relating to different taxes are as listed below:

- income tax – 725,998;
- corporate tax and other direct taxes – 42,999;
- taxes on turnover – 40,041;
- stamp duties – 13,767;
- real estate taxes – 348,056; and
- property tax – 858,334.

12.3 Parties Succeeding in Litigation
Statistics regarding the party (tax authorities or taxpayers) that succeeds in litigation are not published in France.

13. Strategies

13.1 Strategic Guidelines in Tax Controversies
As previously mentioned in 2.6 Strategic Points for Consideration during Tax Audits and 4.5 Strategic Options in Judicial Tax Litigation, the legal and factual analysis of the circumstances of the case are crucial to determine the strategy to be followed in a tax controversy and thus depend on a case-by-case analysis.
Trends and Developments

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Baker McKenzie AARPI works as an integrated global team, covering all multi-jurisdictional aspects and effects of an audit or dispute. The firm has more than 250 tax dispute resolution lawyers worldwide (in over 70 offices), offering broad international experience and deep local know-how in concluding disputes through the full range of administrative and legal dispute resolution techniques. The team of tax litigators at Baker McKenzie Paris acts at each stage of a tax controversy, including assistance with tax audit procedures, negotiations with the French tax administration and litigation before domestic and EU jurisdictions.

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Overview
The latest trends in French tax disputes are mainly related to international tax issues. One of the most striking examples is the increase in the number of cases in which the French tax authorities are challenging the economic substance of non-resident companies. Additionally, the definition of permanent establishments remains a topic of intense interest, with potential future implications due to the rise of remote working.

We have also seen the emergence of new types of tax disputes in which French unions and works councils are challenging the tax position implemented by groups in order to obtain a recalculation of the French employee profit-sharing scheme.

Finally, as far as criminal tax aspects in France are concerned, the number of cases referred to the public prosecutor for tax fraud has increased.

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since 2019, which has led taxpayers to increasingly engage in alternative dispute resolution mechanisms in order to terminate criminal proceedings against them, generally involving the payment of potentially substantial fines.

An overview of these different matters is presented below.

**Economic Substance Challenges**
The French tax authorities increasingly rely on the concept of economic substance of non-resident companies to make assessments aiming at disregarding a non-resident entity and denying the benefit of a favourable tax treatment.

While this kind of assessment is not new, there has been a recent rise in tax disputes aimed at combining challenges of the economic substance of non-resident companies with concepts of beneficial ownership and permanent establishment, in particular the concept of effective place of management, leading, in the latter case, to large assessments.

**Economic substance challenges and beneficial ownership issues**
The concept of beneficial ownership has received heightened attention from the French administrative courts in recent years, leading to a significant number of decisions. The French Supreme Administrative Court has applied this concept, with respect to passive income (interest, dividends, royalties), to deny the application of a tax treaty, where the recipient of such income was considered as not being the beneficial owner.

French case law has gradually developed an analytical framework for the concept of beneficial ownership based on legal, factual and functional criteria guided by economic rationale. For instance, in the Meltex case, the Administrative Court of Appeal of Bordeaux ruled, based on the contractual provisions at hand, that a Dutch company that paid almost all of the royalties received under a trademark sub-license agreement to the trademark owner established in another country could not be considered as the beneficial owner of the royalties (legal test). More recently, in the Foncière Vélizy Rose case, the Administrative Court of Appeal of Paris ruled that a Luxembourg company could not claim to be the beneficial owner of dividends received from its French subsidiary as the dividends were paid to its sole shareholder the day after they were received (factual test) and that it did not demonstrate any economic substance justifying the exercise of an activity distinct from its role as a conduit in the collection and redistribution of the income (functional test).

The French Supreme Administrative Court recently admitted the possibility for both the French tax authorities and the taxpayer, in case of a triangular configuration involving French source income, an intermediary (disregarded as the beneficial owner) and a genuine beneficial owner, to apply the tax treaty between France and the country where this genuine beneficial owner is located, although this can present practical difficulties in terms of identification.

Given these recent developments, the use of the beneficial ownership concept by the French tax authorities could seem more straightforward than applying general anti-abuse rules, which necessitate demonstrating intentional abusive behavior and the execution of specific proceedings by the French tax authorities. As a result, we can expect to see a continued increase in tax audits based on this concept in the future.
Economic substance challenges and effective place of management issues

France has recently observed an increase of tax audits launched by the French tax authorities against non-resident companies. These audits hinge on the concept of “effective place of management”. The aim is to challenge the reality of these companies’ establishment in another country, and to tax their corresponding profits, attributing them to a permanent establishment in France. This type of tax audit could generate serious consequences in terms of statute of limitations, penalties as well as potential criminal implications and lead to double taxation issues.

While such approach could seem legitimate when it is demonstrated that the non-resident entity has no substance where it is established, it appears that the French tax authorities do not limit themselves to this type of situation and sometimes intend to adopt such an approach for non-resident entities with genuine economic substance abroad (characterised for instance by the presence of significant human and technical resources, as well as executives) that have shareholders or board members in France, including both individuals and legal entities. Consequently, French tax authorities have recently targeted French groups believed to manage specific foreign subsidiaries from within France.

However, the legal position on such configurations remains unclear. To date, case law affirming the existence of an effective place of management in France primarily revolves around situations in which it was considered that the non-resident entity had no substance and that the resources used for the conduct and management of its business were located in France.

Recent Trends in Resolution of French Transfer Pricing Controversy

Transfer pricing disputes are increasing globally in terms of frequency, complexity and the financial stakes involved. France is no exception. As a result, transfer pricing audits of multinational companies have become a major focus for the French tax authorities. Most of the multinational companies subjected to a tax audit in France will also have their transfer pricing policy scrutinised by the French tax authorities during the audit.

In this context, the French tax authorities tend to challenge the functional analysis presented by the taxpayer and the resulting selection of the most appropriate method. They may even challenge the taxpayer’s business model, particularly when they disregard the party bearing the risks as an entrepreneur. They also tend to tackle issues on business restructurings, intangibles valuation and financial transactions.

In certain instances, taxpayers might prefer an out-of-court settlement to sidestep the unpredictability of litigation and the possible criminal ramifications associated with transfer pricing cases. Moreover, to protect their public reputation, taxpayers may prefer to resolve transfer pricing cases outside the courtroom.

In this context, the number of Advance Pricing Agreements (APAs) requests has increased over recent years as taxpayers seek to secure their transfer pricing policy ahead of tax audits. While APAs serve to provide taxpayers with certainty, in France the APA process can take several years without any assurance of reaching an agreement by the end. Furthermore, filing an APA does not preclude the initiation of tax audits, which would likely have to be managed in parallel.
Permanent Establishment Controversy in France: Two years on from the Conversant Case and the Future Impact of Remote Working

The French Supreme Administrative Court, sitting in “plenary” formation, issued a ruling on 11 December 2020 that established principles that lead to a broad scope for treaty provisions preceding the Multilateral Instrument (MLI) with regard to the characterisation of a permanent establishment (PE).

In this ruling, the French Supreme Administrative Court determined that a French company should be considered a dependent agent PE when it possesses the power to bind an Irish entity in a commercial relationship, involving transactions that constitute the Irish company’s activities. This occurs when the French company makes decisions on transactions that the Irish entity merely endorses, and when so endorsed, bind the latter. The fact that the French entity did not formally enter into contracts in the name of the Irish company was not deemed relevant. To arrive at this conclusion, the Supreme Court expressly referred to commentaries issued after the entry into force of the treaty between France and Ireland.

Following this landmark ruling, which makes it easier to prove the existence of undisclosed PEs, the post-COVID-19 work landscape may present new PE challenges.

Companies must exercise extreme caution when permitting employees located in a different country from the head office where the employer is established, to work remotely. This is particularly crucial in light of the Conversant case law that focuses on commercial discussions employees might have in France with clients.

Digital Services Tax: Increase in Revenues and First Tax Audits Initiated by the French Tax Authorities

Bruno Le Maire, the French Minister of the Economy, Finance, and Recovery, has recently projected that the French digital services tax (DST) will yield an estimated EUR591 million in 2022, with anticipated revenues reaching EUR670 million in 2023. This substantial rise, nearly double the revenue generated in 2019 – the inaugural year of the French DST – is attributed to the dynamism of the industry and the additional revenue expected in 2023 from the companies falling within the scope of the tax.

In a nutshell, the French DST targets digital intermediation and targeted advertising services provided by larger companies in the digital sector (exceeding certain thresholds) and applies, at a single rate of 3%, to the proportion of the revenue generated by the latter from the use of those services in France.

Due to the significance of this matter, first tax audits covering French DST have now been initiated by the French tax authorities. This trend will continue over the coming years. The statute of limitation period is six years, so the French tax authorities will have until 31 December 2025 to propose DST reassessments related to taxable amounts collected in 2019.

A New Kind of Tax Controversy: French Unions and Works Councils Challenge Companies’ Tax Policies

In recent years, there has been an increase in the number of disputes between French entities and their unions and works councils, the latter challenging the tax position implemented by groups in order to obtain a new calculation of the employee profit-sharing scheme.
The French employee profit-sharing scheme, which is mandatory for companies with over 50 employees, is intended to encourage employee participation in the success and capital of the companies they work for, by allowing them to receive a share of the net taxable profit made by the companies.

The profit-sharing amount is typically calculated using a legal formula that factors in various financial elements of the entity, including net taxable profit, net equity, wages and added value. As a result, any change in net taxable profit will inevitably result in an adjustment to the profit-sharing amount distributed among the workforce.

To ensure the accuracy of the net taxable profit used for calculating profit-sharing, this figure must be certified by either a tax inspector or a statutory auditor. This is a key element since the French Labour Code provides that once the net taxable profit has been certified, this amount cannot be challenged in court. However, this principle only applies to disputes between employees and their employers.

In view of this principle, we have observed an increase in the number of cases in which French unions and works councils have attempted to prove that companies deliberately manipulated net taxable profit to reduce employee profit-sharing. The issues commonly raised include:

- the amount of interest/management fees/royalties paid by related entities; and
- the functional analysis presented by the taxpayer and the resulting selection of the most appropriate method.

Until now, the French Supreme Civil Court, strictly applying the above-mentioned principle, has consistently held that even in the case of alleged fraud or abuse invoked against the company, the amount of the net taxable profit certified by a statutory auditor cannot be challenged. It should be mentioned that such a position is not systematically followed by lower civil courts and that some French unions and works councils are still trying to challenge net taxable net profit even though it has been certified by a statutory auditor.

Finally, it is important to mention that French unions and works councils have also brought criminal allegations against companies in their efforts to secure employee profit-sharing payments, which can lead to serious consequences for the companies involved.

Latest Trends Regarding French Criminal Tax Aspects and the CJIP Procedure

Since the implementation of Law No 2018-898 on the fight against fraud, dated 23 October 2018, the French tax authorities are obligated to report to the public prosecutor the facts they examined as part of a tax audit that resulted in tax adjustments exceeding EUR100,000 and the application of certain tax penalties.

As a result, the number of cases forwarded by the French tax authorities to the public prosecutor increased by almost 75% between 2018 and 2021.

Due to the overwhelming demands placed on the French justice system, the development of "negotiated justice" instruments became necessary. This led to the expansion of the scope of two criminal settlement proceedings under the aforementioned law: the convention judiciaire d'intérêt public (CJIP), a criminal settlement applicable only to legal entities and which is close to deferred prosecution agreements; and the comparution sur reconnaissance préal-
able de culpabilité (CRPC), a criminal settlement which is close to plea bargaining agreements, for cases involving alleged tax fraud.

Since 2019, nine CJIP have been concluded with respect to facts that, upon investigation, could potentially be classified as tax fraud, complicity in tax fraud, or money laundering of tax fraud. The total amount of public interest fines imposed amounts to nearly EUR1.217 billion, in addition to the additional taxes that taxpayers were required to pay to the French tax authorities in such cases.
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