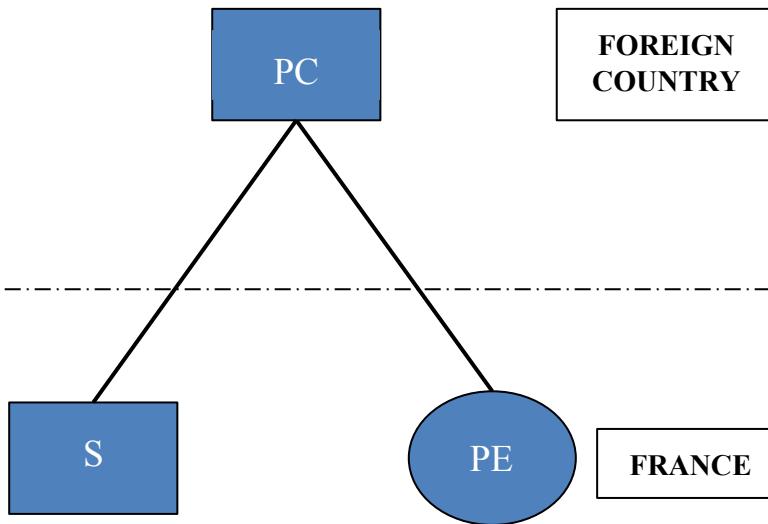


# FRENCH TERRITORIALITY

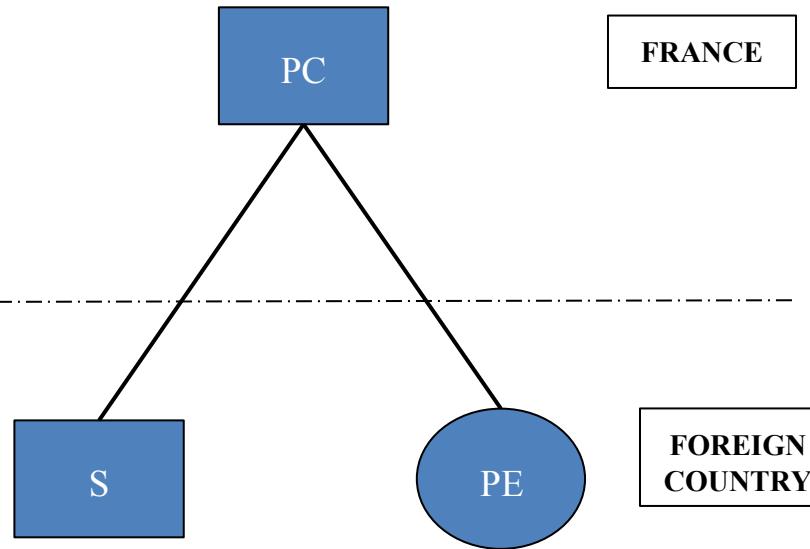
Master 2 DFA - Rennes Law School 2nd May 2017

# TERRITORIAL TAXATION IN A NUTSHELL

## ACTIVE INCOME REALIZED IN FRANCE



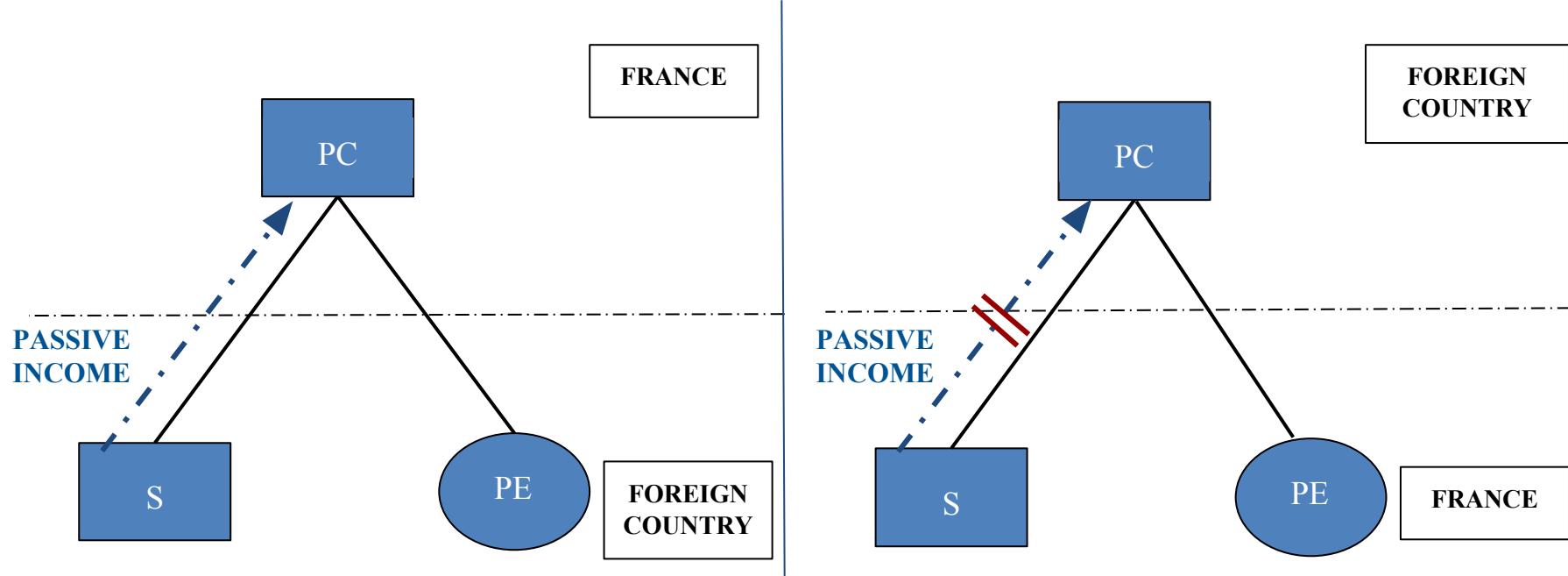
## ACTIVE INCOME REALIZED IN FOREIGN COUNTRY



Taxation in  
France

No taxation in  
France

# TERRITORIAL TAXATION IN A NUTSHELL



Taxation in  
France

Withholding  
tax in France

# INTRODUCTION

**CIN** ⇒ Investors creating an entity in a country must be in the same competitive situation as a company based in this country : **exemption method**

- **Pros :**
  - Residents and non-tax residents are subject to the same tax burden ;
  - This neutrality is more likely to promote international trade than export neutrality.
- **Cons :**
  - Tax residents are not subject to the same tax burden depending on the place of their investments;
  - This system runs against the objective of fiscal neutrality ;
  - This system encourages investment in low-tax state.

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A - Notion of business conducted in France

B - Consequences of the application of French corporate tax

## II - Mechanisms to preserve the territoriality principle

A - Allocation of profits between States

B - Circumvention or permanent establishment concept

# I - TERRITORIALITY PRINCIPLE

## A - Notion of business conducted in France

- 1) Autonomous establishment
- 2) Dependent agent
- 3) Complete commercial cycle

## B - Consequences of the application of French Corporate tax

- 1) Exclusive taxation in France where the business is operated
- 2) Limited taxation without operation in France

# A. Notion of business conducted in France

## 1. Autonomous establishment

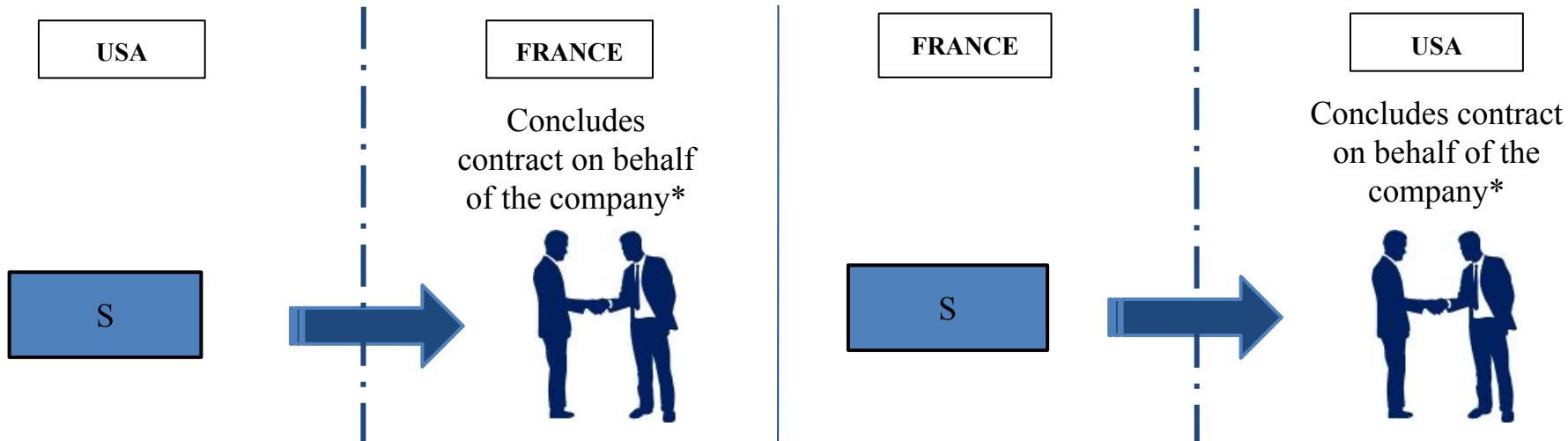
*(Similarities with art. 5.1 OECD Model)*

- **Permanent installation:** *Physical and material presence in France (e.g.: real estate property, industrial machines...).*
- **Activity that aims at generating profits:** *Presumed to be fulfilled as long as the establishment pursues an economic goal.*
- **Autonomous management:** *The management has to take place within the establishment (decision makers, signature of contracts, separate employees, separate accounting...).*

# A. Notion of business conducted in France

## 2. Dependent agent

*(Similarities with art. 5 OECD Model)*



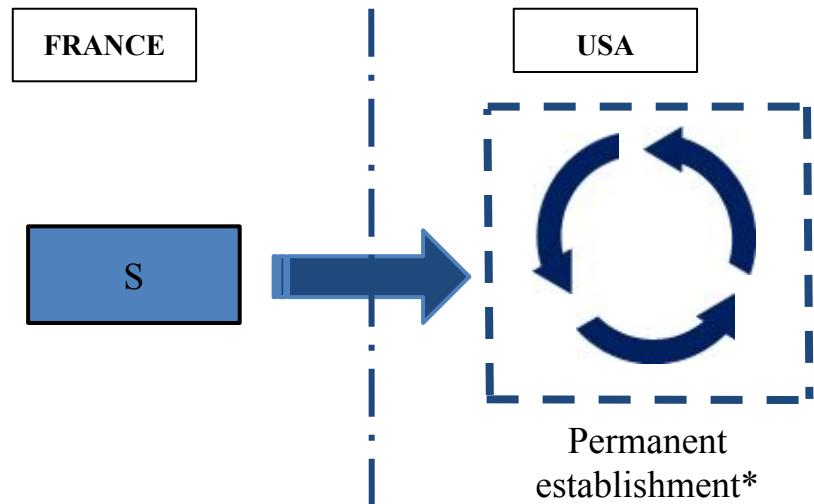
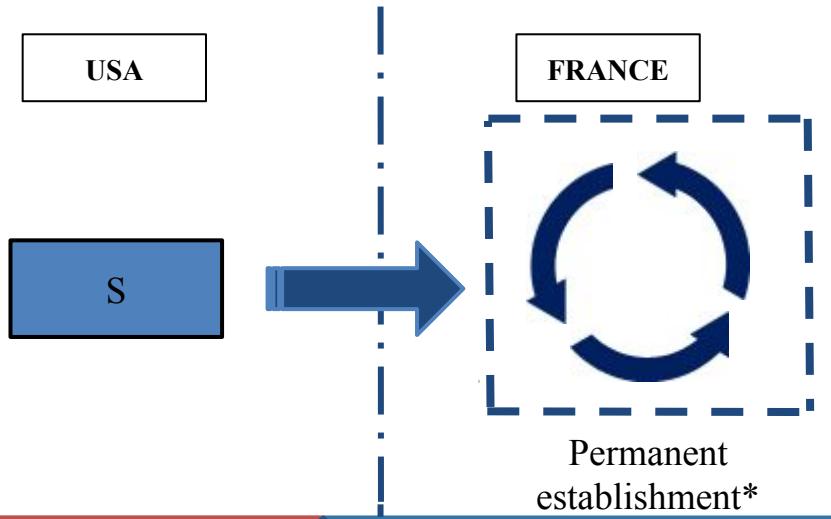
Subordination relationship between the company and the dependent agent

Subordination relationship between the company and the dependent agent

# A. Notion of business conducted in France

## 3. Complete commercial cycle

*(Not in the OECD Model)*



Permanent  
establishment\*

*\*See Marbrek example*

## B. Consequences of the application of French corporate tax

### 1. Exclusive taxation in France where the business is operated

- **Inbound taxation :**

- Taxation of profits earned by a foreign company in France
- In order to link revenues and expenses to the French exploitation, two main methods exists : accountability method and lump sum methods

- **Outbound taxation :**

- Exemption of profits earned by a French company abroad
- Necessary corollary for this exemption : non-deductibility of foreign losses

## B. Consequences of the application of French corporate tax

### 2. Limited taxation without operation in France

- A French company which carries all its activity through foreign exploitation does not pay tax in France on its profits
- France apply a wide territoriality principle, compared to State such as Hong Kong which applies a strict territoriality principle

## **II - MECHANISMS TO PRESERVE TERRITORIALITY PRINCIPLE**

### **A - Allocation of incomes between States**

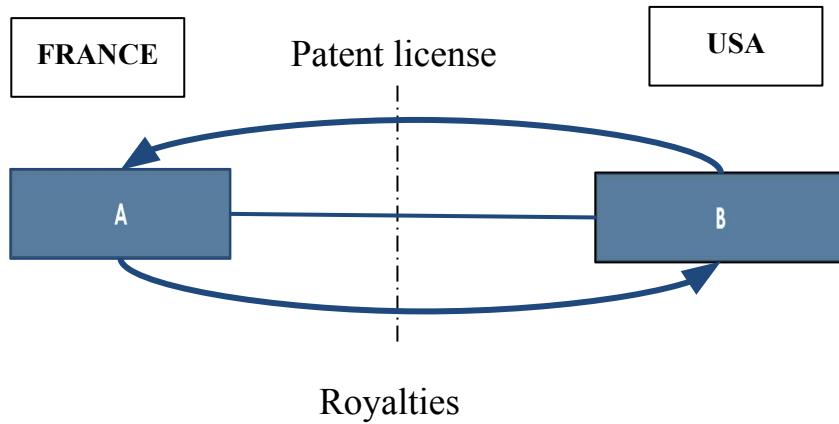
- 1) Transfer pricing rules
- 2) Controlled foreign company rules

### **B - Necessity to change the notion of exploited business**

- 1) Circumvention of exploited business concept
- 2) Action 7 of the BEPS project (regarding dependent agent)

# A. Allocation of incomes between states

## 1. Transfer pricing rules

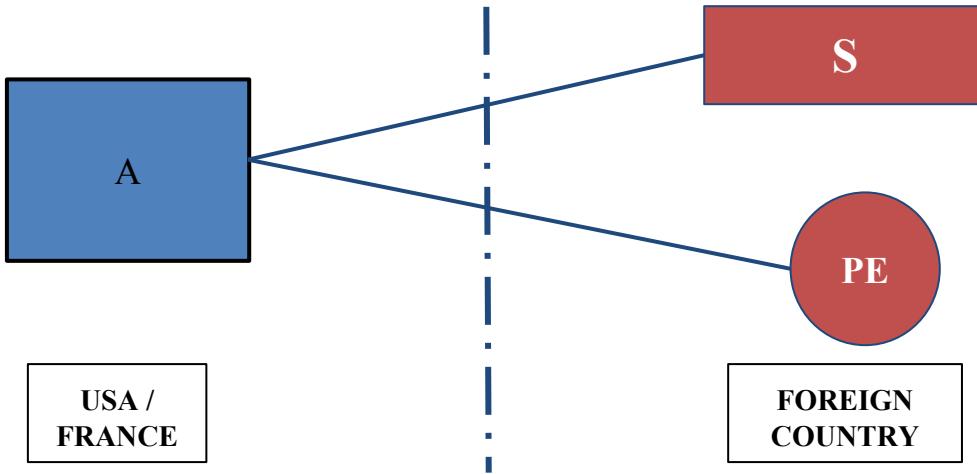


Overvaluation of royalties to reduce the taxable income in France

- Consequences of *article 57 of French Tax Code*:
  - Reintegration of transferred profits to the French company taxable income;
  - Withholding tax, except:
    - application of treaties;
    - income repatriation.
- “*Arm's length principle*” (Article 9 OECD Model)

# A. Allocation of incomes between states

## 2. Controlled foreign company rules



Profits taxed at a low taxation rate at the level of the subsidiary/branch. No taxation of dividends at the level of the French holding

### Conditions for CFC:

- 50% participation hold directly or indirectly
- Controlled entity located in a low taxed jurisdiction (<50% French taxation)

### Consequences:

- For the subsidiary: Assumption that all revenue have been distributed
- For the PE: Taxation in France of the profits

Exception : safeguard clause  
(genuine economic activity)

## B. Necessity to change the notion of exploited business

### 1. Circumvention of exploited business concept

#### **Replacement of distributor with commissionnaire arrangements:**

- Conseil d'Etat, *Zimmer*, 31 march 2010,
- *Google example*.

#### **Strategies based on the preparatory or auxiliary activities in article 5(4) OECD model:**

- *Amazon example*.

## B. Necessity to change the notion of exploited business

### 2. Action 7 of the BEPS project (regarding dependent agent)

- Scope of the dependent agent expanded to include situations where an agent “habitually concludes contracts or habitually plays the principal role, leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise”.
- Exclusion of certain activities from the definition of PE: will only apply where the activities are preparatory or auxiliary in relation to the business as a whole.

# CONCLUSION - *Pros & Cons of the territoriality principle*

- **Territoriality principle :**
  - Import neutrality
  - Fairer taxation
  - Encourages investment in low-tax states
- **Worldwide taxation :**
  - Export neutrality
  - No distinction between residents if their income is national or foreign
  - Budgetary interest (for the State)



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