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Instruction on the Advance Pricing Arrangement Procedure

(Offices CF3, E1, T3 and AGR)

Economic Background to the Measure

International transactions between associated enterprises are becoming an increasingly important tax issue. Such enterprises must price their internal transactions according to the arm's length principle, which means applying prices that independent enterprises would charge in identical transactions.

Traditional tax examinations of transfer pricing issues can create legal uncertainty for businesses. Such examinations are often long and difficult and they entail heavy costs for both businesses and government. Since examinations always come after the fact, it is difficult to produce enough information to justify an enterprise's transfer pricing practices.

The government, in response to the demands expressed by professionals, proposes a provision for an advance pricing arrangement with a view to reducing transfer pricing difficulties. The provision is intended for cases where implementation of the arm's length principle raises major reliability and accuracy problems or where the specific context of the transactions is unusually complex.

The arrangements shall be concluded between the competent authorities of two States within the legal framework of the mutual agreement procedure provided for in tax conventions.

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1 - OBJECTIVES OF THE ADVANCE PRICING ARRANGEMENT PROCEDURE

The advance pricing arrangement is a procedure that provides legal certainty and stabilises the tax environment of multinational enterprises. French and foreign firms that so desire can enter into an agreement with the tax administration on the method to be used for pricing their future intra-group transactions. This procedure avoids the problems encountered by multinational enterprises and also ensures that the method used in compliance with tax laws also complies with the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations published by the OECD in 1995. Advance pricing arrangements do not create any new tax base rules and the details given in the basic documentation 4 A 1211 of 1 September 1993 remain fully valid.

The bilateral nature of advance pricing arrangements (see 2 below) means that they eliminate the risk of double taxation, while at the same time preserving the tax base of the Contracting States.

2 - DEFINITION OF AN ADVANCE PRICING ARRANGEMENT

An advance pricing arrangement between competent authorities enables multinational enterprises to define a transfer pricing method in agreement with the tax authorities. This will ensure that the French tax administration does not regard their pricing of industrial, commercial and financial intra-group transactions as being planned profit transfers under the terms of Article 57 of the General Tax Code.

The advance pricing arrangement determines a method to be applied over a fixed period. The criteria used are the ones the competent authorities and the enterprise concerned consider to be the most appropriate. The method defines the conditions under which the arrangement is approved. It then enables the enterprise concerned to calculate the transfer prices to be used for future transactions between related enterprises¹.

The arrangement is an agreement signed between two tax administrations and its implementation requires the acceptance of the enterprises concerned.

CHAPTER ONE

SCOPE OF ADVANCE PRICING ARRANGEMENTS

SECTION 1

BASIS OF ADVANCE PRICING ARRANGEMENTS

¹ According the OECD's definition in paragraph 4-124 of its transfer pricing guidelines, " An advance pricing arrangement ("APA") is an arrangement that determines, in advance of controlled transactions, an appropriate set of criteria (e.g., method, comparables and appropriate adjustments thereto, critical assumptions as to future events) for the determination of the transfer pricing for those transactions over a fixed period of time."

The advance pricing arrangement procedure is intended to eliminate the risk of double taxation by establishing an agreement between the two Contracting States. Transfer pricing is a bilateral issue because it affects the budgets of two governments.

Agreements between tax authorities shall define the rules for sharing the tax base with the primary aim of preventing double taxation. The basis of such agreements is Article 25.3 of the OECD Model Tax Convention.

Consequently, advance pricing arrangements may only be entered into with States that have signed a tax convention with France that includes a provision along the lines of Article 25.3 of the OECD Model Tax Convention.

SECTION 2

TRANSACTIONS COVERED BY ADVANCE PRICING ARRANGEMENTS

The arrangement shall deal with the method to be used and shall not fix the actual prices for transfers within a multinational enterprise.

Applications for advance pricing arrangements may relate to all transactions between the related enterprises², as stipulated in Article 57 of the General Tax Code (transactions in tangible and intangible goods or the provision of services), or to transactions between the head office and one or more permanent establishments within a single multinational enterprise.

Depending on the taxpayer's application, the advance pricing arrangement may deal with an activity segment, a function, a single product, or even a single type of transaction. The scope of the arrangement may be broad or narrow, depending on the elements put forward by the enterprise and its impact on the tax base of the other State.

CHAPTER TWO

STEPS IN THE ADVANCE PRICING ARRANGEMENT PROCEDURE

Enterprises shall be encouraged to consult the tax administration to examine the conditions under which an application for an arrangement can be made and examined before they start drafting their application. This preliminary meeting, before an official application is made, shall provide an opportunity for discussing the benefits of an arrangement, the information required for an analysis of the enterprise's transfer pricing policy, a timetable for the work and all the issues relating to the procedure for examining the application.

SECTION 1

INITIATING THE PROCEDURE

² These are enterprises that depend on or control enterprises outside of France, or that depend on an enterprise or group that also controls the enterprises concerned located outside of France.

A taxpayer shall initiate the procedure by contacting the office in charge of negotiating arrangements (see Chapter Five). The application must be filed six months before the start of the first financial year covered by the application (without prejudice to the exemption provided for in the "Retroactivity" paragraph).

The taxpayer shall propose a transfer pricing method and provide all of the commercial, industrial, financial and legal data required to support its assertion that the method produces prices in compliance with the arm's length principle.

The fact that a taxpayer is being audited shall not be an obstacle to applying for an advance pricing arrangement to cover future transactions.

Applying for an advance pricing arrangement shall not cause the suspension of tax examination in progress, or any other tax investigation or assessment procedure. Nevertheless, there shall be nothing to prevent an ongoing tax examination from being extended to other tax years not covered by the initial audit of the accounts, in the course of examining an application for an advance pricing arrangement.

The taxpayer's application shall be drawn up bilaterally and filed with the General Tax Directorate.

Enterprises shall file an application in the other State concerned at the same time as their application in France. The taxpayer shall file a copy of this application within two months of the date of the application to initiate the procedure in France.

The taxpayer shall provide all of the information required to support the application and analyse the planned transfer pricing method (see Appendix for an indicative list of the documents required).

The documents shall be filed in a mutually agreed format.

The tax administration may require translation into French of documents filed in a foreign language.

Initiating an advance pricing arrangement procedure shall not affect the term of limitation on the tax administration's actions and the examination of an application shall not be an obstacle to initiating a tax examination procedure.

SECTION 2

EXAMINING APPLICATIONS FOR ADVANCE PRICING ARRANGEMENTS

SUB-SECTION 1

PROCEDURES FOR EXAMINING APPLICATIONS

An advance pricing arrangement shall require co-operation between the enterprise and the tax administration.

The parties need to discuss the transfer pricing method and the transactions submitted for the tax administration's scrutiny. Technical meetings shall be held to enable the taxpayer to present the documents required for analysis of the transactions concerned and to justify the method it plans to use.

In the course of examining the application, the French tax administration shall analyse the taxpayer's proposed method jointly with the competent authority from the other State concerned, as part of the parallel negotiations between them.

The French tax administration officials examining the application may, with the consent of the enterprise, make site visits. The enterprise, or its counsel, shall provide the administration with the elements it needs to analyse the proposed method by all appropriate means (documentation, site visits, presentations of industrial and commercial techniques, etc.)

While the application is being examined, the enterprise shall inform the French administration of progress on the procedures initiated with the other competent authorities and shall provide the French administration with the same documents that it provides to the foreign authorities.

SUB-SECTION 2

DOCUMENTATION

The administration shall have access to all documentation that enables it to interpret the enterprise's transfer pricing policy.

In addition to providing the documents needed to analyse the method, the taxpayer may have to produce any accounting or non-accounting document that may help the officials examining the application (see the Appendix for an indicative list of the documents that may have to be produced).

The taxpayer shall justify the transfer pricing method chosen. For this purpose, the taxpayer shall as far as possible:

- Compile relevant data on prices charged in comparable uncontrolled transactions;
- If such data are not available, the taxpayer shall identify all of the transactions that may be comparable, but for which accurate data are not available;
- If such transactions cannot be identified, the taxpayer shall compile relevant data on the prices charged in similar uncontrolled transactions, even if they are not strictly comparable and propose the necessary adjustments for applying them to its own operations.

If no comparable data is available, the taxpayer shall prove that its method produces prices that approximate arm's length prices.

The taxpayer's proposed transfer pricing method implies assumptions about future transactions. As such it may be affected by changes in business and operational conditions. These changes may have an impact on the arrangement parameters at the time the future transactions are made.

Therefore, the enterprise shall propose critical assumptions, meaning thresholds or parameters that the enterprise feels are likely to jeopardise the validity of its method, making it necessary to:

- Revise the method (in this case, the enterprise must define the conditions for revising its method);
- Suspend the method for the residual term of the arrangement.

The critical assumptions shall be analysed in detail as part of the arrangement negotiations. The taxpayer shall support its application for an arrangement by presenting the main parameters that are decisive in determining the transfer pricing method. The taxpayer shall also explain how the chosen method can be adapted to certain changes in the implementation conditions presented at the time the application is filed. These assumptions shall then be submitted to the tax administration for approval.

If the taxpayer deems it useful, it may present a technical report by an expert (in economics, finance or other matters) aimed at validating its choice of method. The taxpayer may also provide more details about business conditions in its activity sector, or else provide more details about the nature of the transactions covered by its application.

The tax administration shall retain the right to require more documents, such as analyses and reports, that it deems helpful for examining the chosen method.

Any information that the tax administration asks for in writing shall be submitted without delay.

SUB-SECTION 3

CONFIDENTIALITY OF INFORMATION RECEIVED

Confidentiality of information cannot be invoked as a reason for refusing to produce a document. The tax administration shall be bound not to disclose the information received to any third party, other than the competent authority of the other Contracting State, and to abide by the confidentiality rules relating directly to the existence and the amount of the taxpayer's tax liabilities. The tax secrecy rules shall apply to information received as part of the arrangement.

SECTION 3

NEGOTIATIONS WITH THE OTHER COMPETENT AUTHORITY

Once the tax administration has established its position on the taxpayer's proposed transfer pricing method and informed the taxpayer of its position, it shall continue to examine the method jointly with the competent authority from the other Contracting State.

The tax administration shall keep the taxpayer informed of progress during these discussions and may require the taxpayer to provide further information, depending on the direction of the discussions.

If, following these discussions, the other competent authority reaches the conclusion that it does not wish to give its consent, the procedure shall be ended and the taxpayer shall be so informed.

CHAPTER THREE

CONCLUDING ADVANCE PRICING ARRANGEMENTS

SECTION 1

FORM

When the French tax administration and the competent authority of the other Contracting State reach an agreement, the unit examining the application shall send the taxpayer a letter defining the terms of the arrangement (see "Content" below). The taxpayer then responds by acknowledging its acceptance and undertakes to abide by the implementation conditions of the arrangement.

The taxpayer must sign its letter of acceptance.

The arrangement is confidential.

NB: Enterprises should note that some countries have specific disclosure requirements that apply to certain parts of the arrangements concluded with the local tax administration.

SECTION 2

CONTENT

The tax administration's letter to the taxpayer shall contain the following information:

- Enterprises and transactions covered by the arrangement;
- Description of the transfer pricing method to be used;
- Description of the critical assumptions and procedures for revising or cancelling the arrangement (corresponding adjustments or other automatic mechanisms);
- Date the arrangement enters into force;

- Term of the arrangement or the tax years covered by the arrangement;
- Information to be provided in the "annual report" and the monitoring procedure set up under the arrangement;
- Conditions for renewal of the arrangement.

SECTION 3

TERM

The arrangement shall enter into force at the date agreed by the parties.

The term of the arrangement shall be set during the negotiation procedure. It shall not be less than 3 years or more than 5 years. The main factors determining the term of the arrangement shall be the sector and specific product features involved the taxpayer's business. Arrangements already entered with other competent authorities are also considered with a view to having the arrangements cover the same periods.

SECTION 4

EFFECTS

SUB-SECTION 1

SCOPE OF THE COMMITMENT

The tax administration shall refrain from repudiating an arrangement signed with another competent authority, except in the following cases:

- Misrepresentation of facts, dissimulation of information, errors or omissions attributable to the taxpayer in the drafting of its application;
- The taxpayer's failure to abide by its obligations under the arrangement or fraudulent acts.

In these cases, the unit having approved the arrangement shall deem it to have been null and void from the date of its entry into force. The other country's competent authority shall be informed of the failure to comply with the arrangement.

If there is an external tax examination of the tax years covered by the arrangement, the tax inspector's investigations shall not lead to the terms of the arrangement being brought into question. However, the unit shall have to verify the fair presentation of the facts by the taxpayer during the examination of the application and the taxpayer's compliance with its obligations under the arrangement, as well as the critical assumptions underlying the arrangement or which trigger a revision of the arrangement.

If an event modifies the parameters of the arrangement, it shall be revised by mutual agreement between the parties or suspended as of the date of the event.

SUB-SECTION 2

RETROACTIVITY

Advance pricing arrangements shall not be retroactive.

However, as an exception to the rule set out in the first paragraph of the "Initiating the procedure" section, the arrangement may apply to the tax year in which the application for an arrangement is filed, if the enterprise requests it at the time of filing.

CHAPTER FOUR

MONITORING MECHANISM AND RENEWAL

SECTION 1

MONITORING PROCEDURE

The monitoring procedure shall be determined by the arrangement between the enterprise and the French tax administration.

The taxpayer shall produce an annual report under conditions set out in the arrangement. The purpose of the report shall be to verify that the methods implemented comply with the terms of the arrangement. Failure to produce an annual report within 30 days of formal notification of default shall lead to the cancellation of the arrangement as from the tax year that should have been covered by the missing report.

The enterprise must keep all of the documentation relating to transfer pricing (in compliance with the provisions of Article 102 B of the Tax Procedure Manual (LPF)) and make it available to the tax administration.

If the implementation of the method leads to results that are different from those provided for in the arrangement, then it may be revised using the adjustment mechanisms provided for under the arrangement.

SECTION 2

RENEWAL PROCEDURE

The arrangement may be renewed at the request of the enterprise. The renewal application must be filed with the tax administration 6 months before the term of the arrangement expires. If the renewal application is not received by the deadline, the administration shall explicitly inform that taxpayer that the arrangement will be rescinded when its term expires.

If the administration formally agrees in principle to renewal of the arrangement, the new negotiation procedure (which shall comply with the same examination

procedures as the negotiations for the original arrangement) may be streamlined, if there are no material changes in business conditions or the main parameters of the earlier agreement.

CHAPTER 5

ADMINISTRATIVE ORGANISATION

The main purpose of the provision for advance pricing arrangements is to eliminate the risk of double taxation through an arrangement entered into with another Contracting State. This means that the competence for negotiating such arrangements lies with central government.

Office CF3 is responsible for examining applications and drafting and signing arrangements. All applications and information from taxpayers, including the annual report once an arrangement has been entered, must therefore be sent to Office CF3.

From the outset of the examination procedure, Office CF3 shall call upon an official with thorough knowledge of the enterprise's activity sector to assess the taxpayer's business conditions, specific market features, etc.

Officials examining arrangements may call upon specialists and experts from the Ministry of the Economy, Finance and Industry as required.

For further information about advance pricing arrangements and about drafting applications, contact:

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64_70 Allée de Bercy
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APPENDIX

1. Documents to be presented in support of the application

The following is an indication of the documents an enterprise may be required to produce when filing an application:

- Organisation chart for the whole group and list of entities covered by the application for an advance pricing arrangement, company name, address, tax identification number of the "parties" to the arrangement;
- Description of the group's industrial and commercial operations, its world-wide structure, its ownership structure (holding chains, percentage shares, ownership structure of foreign entities, shareholder agreements, types of securities held, voting rights, etc.), market capitalisation, financial agreements, main activities and the site(s) where these activities are located, along with the main transaction flows between the parties;
- Representative financial and tax data relating to the parties for the previous three tax years, along with any other data or documents likely to support the proposed transfer pricing method;
- Indication of the operating currency of each party and the currency used for payments in transactions between the parties for the operations covered by the arrangement;
- Indication of advance pricing arrangements entered into by other enterprises in the group or covering transactions other than those specified in the application filed with the French tax administration;
- Term of each party's tax year;
- Description of the main financial accounting methods used by the entities located abroad that have a direct impact on the proposed transfer pricing method;
- Tax rules applied to the transactions concerned;
- Analysis of statutory provisions, tax conventions, court rulings, regulations, rulings or proceedings involving the income relating to the proposed transfer pricing method;
- Description of any disputes relating to the transfer pricing method that have been or are being examined, indicating the taxpayer's position and that of the administration involved, along with any solutions finally adopted. This covers court proceedings in progress or already settled and proceedings pending before competent authorities in France as well as in other countries.

2. Justifying the taxpayer's choice of transfer pricing method

The method implemented by the enterprise may be deemed to be acceptable if it produces prices that comply with the arm's length principle and the presentation is backed up by supporting documents:

- Dealing with methodology and documentation: for example, an internal document describing the method, any contracts or contractual documents exchanged between the entities of the group involved in the transactions, which set out any mutual obligations of the parties, etc.
- Dealing with accounting issues: any financial statements and any cost accounting documents;
- Dealing with economic issues: any considerations or data relating to the markets and function of the group's entities involved that explain the method implemented by the enterprise (e.g. using low prices to penetrate a market requires the enterprise to provide information about research into this market, its specific characteristics and those of the related entity involved, particularly ownership, functions performed and risks incurred, provisions for assessing the results of the method used and, as appropriate, for revising it); where appropriate, any information and analysis about the choice of comparable transactions justifying the validity of this choice.

For example, the administration shall be provided with the following information, which is needed to establish whether the proposed transfer pricing method complies with the arm's length principle:

- Functional analysis of each party, showing its business activities, the assets used, the economic costs incurred and the risks borne;
- Business analysis or research on pricing practices and the business functions performed as observed in the activity sector and in the geographical areas covered by the arrangement;
- List of the taxpayer's competitors and an analysis of a few transactions, activities or enterprises that are not under the group's control, that could be comparable or similar to those covered by the application;
- Relevant profit and return-on-investment measurements;
- Detailed report on research and the criteria used to identify and select the non-related comparables, along with how the criteria were applied to the potential comparables. This report shall include a list of potential comparables and notes explaining why each of them has been selected or rejected;
- Detailed notes explaining how the factors used to adjust the selected non-related comparables in order to develop the proposed transfer pricing method were selected and applied.