

News Analysis: Courts Take Hard Line in Transfer Pricing Disputes

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Reprinted from *Tax Notes Int'l*, September 30, 2013, p. 1284

COUNTRY DIGEST

NEWS ANALYSIS

Courts Take Hard Line in Transfer Pricing Disputes

Two French administrative courts of appeal have issued decisions¹ affirming transfer pricing reassessments based on economic dependence and on the taxpayer's failure to meet the burden of proof.

In a case analyzed by the Administrative Court of Appeal in Lyon, the taxpayer (LVD), which manufactures and markets chairs for the disabled, entered into a contract with a Swiss related party, Lifestand International SA (LSI), on January 7, 2003, under which LSI was granted the exclusive distribution of LVD's products (except in Germany, where the distribution was carried out through LVD's subsidiary, and in France, Greece, and Eastern Europe).

LVD had handled the distribution itself (through its subsidiary and local importers) before the contract with LSI and resumed that activity after January 1, 2006, when it broke the contract. However, even under the distribution agreement with LSI, the management of the trade orders did not change.

For the duration of the contract with LSI, local importers and LVD's German subsidiary submitted their orders to the assessee, which issued order confirmations to those distributors, stating the price charged by LSI. Upon receipt of the goods, LVD shipped them to the local importers and the German subsidiary.

LSI was required to use LVD's logos and trademark and could not change the name "Lifestand" because it was a registered trademark of LVD. Furthermore, LVD produced all the promotional documents and developed the website used by LSI, and had to approve any promotional activities undertaken by LSI.

LSI's sales prices were established in the distribution agreement and could be changed only by LVD, and all

the invoices and all payments had to be "denominated in euro or in the currency of LVD," according to the case documents.

According to the French tax administration, LSI, which had only one employee, did not have the human and material resources to perform the functions of the distribution agreement. Furthermore, LSI was based in Switzerland at a registered address, its accounts contained no rental rate for commercial premises in 2004, and it was listed on an organizational chart as an export service of LVD.

Most of the functions assigned to LSI were routinely performed by LVD, and LSI was fully economically dependent on the assessee, the tax authority said. Finally, the manager of LVD exercised management and control of LSI because he received all orders and determined their allocation free of charge, it said.

Although no capital link was established between the two companies, the court agreed that LVD clearly exercised management and control of LSI and that the latter was economically dependent on the assessee. Therefore, because most of the distribution operations outside France were made by LVD, the commission it received — which corresponded to 25 percent of the sale price invoiced by LSI to the foreign clients — constituted a transfer of profits between LSI and LVD. The court therefore held that the French transfer pricing rules should apply.

In the other decision, issued by the Administrative Court of Appeal in Nantes, the assessee, Amycel France, sold a product to its sister companies, Amycel BV and Amycel UK, at lower prices than it charged its unrelated customers.

Amycel France justified the price difference, in part, on the following:

- Amycel BV and Amycel UK covered part of the transport, marketing, and storage costs and some of the fixed general administrative costs; and
- the compensation Amycel received from its U.S. parent corresponded to the tariff benefits granted to the sister companies.

However, the court held that those factors did not justify the price difference and that Amycel France had not satisfied its burden of proof.

¹Cour administrative d'appel de Lyon, Chambre 5, No. 11LY00678, July 11, 2013; and Cour administrative d'appel de Nantes, Chambre 1, No. 12NT00223, July 25, 2013.

The court therefore confirmed that the French transfer pricing rules should apply and that the assessee's taxable income was adjusted correctly. ◆

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