TAX NEWS REVIEW

This review of tax news focuses on the main case law decisions of recent months

APRIL 2024

I. Corporate income tax and permanent establishment

CAA Paris, 24 January 2024, *Sté Teads France*, n°22PA03519; CAA Douai, 17 August 2023, *Sté Clan's World*, n°21DA02808

The concept of a permanent establishment is a fundamental element in determining whether a foreign company is liable to corporate income tax in France. When the administrative judge has to rule on this issue, he uses the "bundle of evidence" method, gathering a certain number of factual elements to decide whether or not there is a fixed place of business in France or in a third State. In this context, the practical conditions under which the business is carried on, in both States where applicable, are taken into account.

Two recent rulings by administrative courts of appeal illustrate this methodology, as much as they provide taxpayers with an example of the decisive elements in the judge's analysis.

In a ruling dated 24 January 2024 (CAA Paris, 24 January 2024, *Sté Teads France*, no. 22PA03519), the Paris Administrative Court of Appeal confirmed the absence of a permanent establishment of a French company in Belgium, noting that evidence of a permanent establishment in that State could not be provided simply by submitting the employment contract of the sole employee working in the Belgian branch, a functional analysis report and an exchange of emails that did not enable the reality of the activity carried out by that employee to be assessed. Furthermore, the claimant did not provide any information enabling the nature of the relationship between this Belgian branch and the company's customers, which would lead to the conclusion that its involvement was decisive, nor did the claimant demonstrate that the Belgian employee habitually exercised responsibilities enabling him to conclude contracts on behalf of the company, or that he had any autonomy whatsoever.

In a ruling dated 17 August 2023 (CAA Douai, 17 August 2023, *Sté Clan's World*, no. 21DA02808), the Douai Administrative Court of Appeal confirmed the presence in France of a permanent establishment of a Luxembourg company, by seizing in its premises a "communication plan for the general public" aimed to develop the customer base, minutes of a meeting relating to budget restructuring, emails relating to the organization of a communication meeting with all the directors and franchisees, brand licensing contracts and a document tracking the company's bank movements.

Consequently, the company's strategic decisions were taken in France. This circumstance was an obstacle to establishing the presence in Luxembourg of the company's effective center of direction, a criterion that would have made it possible, on the basis of the Franco-Luxembourg tax treaty, to avoid paying corporate income tax in France.

II. Payroll tax and tax liability ratio: the importance of proving the functions performed by employees or corporate officers

CAA Nantes, 30 January 2024, no. 23NT00974; CAA Paris, 22 March 2024, no. 22PA00303

As a reminder, payroll tax is payable, in principle, by all companies that pay remuneration to their employees, as long as they are not liable for value added tax (VAT) or have not been liable for VAT on at least 90% of their turnover for the calendar year preceding that in which the remuneration is paid (French Tax Code, art. 231).

The basis of assessment for this tax is obtained by multiplying the total taxable remuneration by the ratio existing in the year prior to the payment of this remuneration between the revenue not eligible for VAT deduction and the total revenue (CGI, art. 231, 1). This ratio is known as the payroll tax liability ratio. However, when companies are authorized to set up separate business sectors for VAT purposes, they must then calculate the tax by business sector and, for persons assigned to several business sectors, use the general tax liability ratio.

The Nantes Administrative Court of Appeal (CAA Nantes, 30 January 2024, no. 23NT00974) ruled that since an employee held the position of Chief Financial Officer and was therefore responsible for all matters relating to the Group's financial policy, the company had not produced any evidence to show that the duties carried out would relate to other sectors subject to VAT and that, accordingly, the tax authorities were entitled to apply the financial sector tax liability ratio to his remuneration. It also confirmed that the remuneration paid to the Legal and Tax Director in respect of the acquisition and disposal of the Group's shareholdings should be subject to tax on the basis of the general ratio.

The Paris Administrative Court of Appeal (CAA Paris, 22 March 2024, no. 22PA00303), following the Nantes court's example, pointed out that if it is clear from the information produced by the company that the corporate officers do not have responsibilities in the financial sector, their remuneration must be considered as falling entirely within the sectors subject to VAT and, consequently, as being outside the scope of the tax. It also added that it was up to the company to provide evidence that the directors' remuneration fell exclusively within the sector subject to VAT, which was not demonstrated by the company in the case at hand.

III. Tax treaties: flat-rate tax credits and the cut-off rule

CE, 19 February 2024, no. 469407, *Minister vs Somfy*

In order to avoid double taxation, tax treaties provide entitlement to a tax credit. This tax credit generally corresponds to the tax paid in the source State of the income by the resident of the other State. However, in some tax treaties, States have introduced a so-called flat-rate or fictitious tax credit clause. These clauses allow a tax credit to be deducted even when no taxation has been carried out or less tax has been levied.

This is the case with the Franco-Tunisian tax treaty. According to article 29 of the tax treaty, income that is strictly taxed in Tunisia is either exempt from tax in France, or a tax credit equal to the tax levied in Tunisia is deducted from other income, including royalties. By way of derogation, a flat-rate tax credit of 20% is applicable in France for French tax residents receiving Tunisian royalties from the licensing of patents.

In this case, the French company Somfy received royalties from the licensing of Tunisian patents. These royalties were subject to corporation tax in France at a rate of 15%, the rate applicable at the time.

Chaumont Quéré & Associés
60, rue Pierre Charron – 75008 Paris - Tél. : 01.45.08.44.07.
Email : cabinet@cq-associes.com

The company had initially capped the tax credit at 15%, equal to the French tax, without taking into account the provisions of the tax treaty. The company therefore requested repayment of the overpayment made to the tax authorities in application of this flat-rate tax credit of 20%. The tax authorities rejected its claim on the basis of the cut-off rule.

The French Supreme Court upheld the court's ruling, considering that the cut-off rule did not apply to the tax credit for royalties for the licensing of Tunisian patents, and that Article 29 on the elimination of double taxation was irrelevant in this respect.

This decision is an illustration of the principle that treaties must be interpreted strictly on the question of how double taxation is eliminated (CE, 21 May 2022, no. 461519, Min c/ Sté Hsbc Bank). In this case, patent license fees benefit from an express derogation from the general rules on tax credits set out in the tax treaty, including the application of the cut-off rule.

These flat-rate tax credits were negotiated to promote the economic development of countries. They can still be found in some treaties (e.g. with India and Indonesia), but many were totally or partially abolished when the treaties were renegotiated (e.g. with China and Brazil).