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An extensive French notion of permanent establishment

In a decision dated as of December 11, 2020, the French Administrative Supreme Court ("Conseil d'Etat") adjusted the notion of "permanent establishment", a notion that determines the country in which a company is liable to pay taxes. The judges has overturned a Paris Court of Appeal decision dated March 1, 2018 (which had previously concluded in the absence of a Permanent Establishment under the France-Ireland Tax Treaty) and ruled against the Irish subsidiary ("Irish Co") of a US group. By this decision, the Conseil d'Etat has flagged the way by clarifying the notion of "permanent establishment".

This decision will have implication on the activities of international companies settled in France. They are subject to French tax law – corporate taxes and VAT – only if their activities in France meet the criteria of a "permanent establishment". In some cases, international companies ought to be careful on the autonomy left to their agents and subsidiaries and set up strict validation processes.

Factual background

An Irish Corporation, a subsidiary of a US group and sister company of French Corporation, carried on a digital marketing activity in Europe mainly consisting in selling marketing affiliation, media and technology services in these markets. The French entity was remunerated by the Irish entity on a cost plus 8% basis for various services including administrative and marketing activities & representation (e.g. identification, prospecting, targeting of clients on the French market, etc.). All the contracts concluded with French clients were signed by the Irish entity.

The French Administrative Supreme Court judged that the French entity should be considered as a dependent agent in France of its Irish sister company; even if it did not formally conclude contracts in the name of the Irish entity, since the French Company decided on transactions that the Irish Company simply and systematically approved and as such became legally binding to the Irish entity.

It is important to note that it is the first time that the French Supreme Court:

- has ruled on the existence of a permanent establishment based on the dependent agent test in respect of a digital player
- and used OECD comments released after the signature of an applicable tax treaty, in support of its arguments

This decision will amplify a tendency seen for several years: the extensive interpretation of the notion of permanent establishment by the French administration, confirmed by the French Administrative Supreme Court's decision.

The multilateral BEPS convention of the OECD, a supranational tax treaty?

This decision may likely rise a tendency and also will result in the unilateral application by France of an extensive interpretation of the definition of permanent establishments under Article 12 of the Multilateral Instrument (MLI) adopted with no reservation by France.

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For a reminder In November 2016, over 100 jurisdictions concluded negotiations on the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ("Multilateral Instrument" or "MLI")* that will swiftly implement a series of tax treaty measures to update international tax rules and lessen the opportunity for tax avoidance by multinational enterprises.

Signed in Paris in 2017 by 88 jurisdictions, including France (the United States has not signed it), which is intended to modify automatically (and therefore more rapidly than a bilateral renegotiation of conventions) the corresponding clauses of existing bilateral conventions on the basis of an absence of reciprocal reservations and ratification by States. In France, the MLI was ratified in September 2018 and entered into force on 1 January 2019.

Therefore, the Treaty was binding upon several international companies with commercial operations in France. Since its entry into force in the French legal order, RSM recommends to its foreign clients to be wary, in particular in the management of agents located in France.

Article 12 of MLI: focus on agents' scope

One of the measures adopted (article 12 of the MNI) is the broader concept of the cases in which agents constitute permanent establishments: henceforth, a dependent agent may also constitute a permanent establishment if it usually plays a predominant role in the conclusion of contracts which are entered into without material modification by the foreign company.

Under the article 12, notwithstanding the provisions of a Covered Tax Agreement that define the term "permanent establishment", but subject to paragraph 2, where a person is acting in a Contracting Jurisdiction to a Covered Tax Agreement on behalf of an enterprise and, in doing so, 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, and these contracts are:

- *a) in the name of the enterprise; or*
- *b) for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use; or*
- *c) for the provision of services by that enterprise, that enterprise shall be deemed to have a permanent establishment in that Contracting Jurisdiction in respect of any activities which that person undertakes for the enterprise unless these activities, if they were exercised by the enterprise through a fixed place of business of that enterprise situated in that Contracting Jurisdiction, would not cause that fixed place of business to be deemed to constitute a permanent establishment under the definition of permanent establishment included in the Covered Tax Agreement (as it may be modified by this Convention)."*

Since the decision of the French Administrative Supreme Court of December 11, 2020, the risk that the activity of an agent may be reclassified as a "permanent establishment", subject to French tax regulations, is real. The stakes related to this risk are also all the more important since the fact of having an undeclared permanent establishment can characterise the exercise of a "hidden" activity likely to result in a penalty of 80% on tax reminders and an automatic transmission of the file to the Public Prosecutor's Office since the law relating to the fight against fraud of 23 October 2018 in the context of tax fraud proceedings.

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In conclusion, the decision being broad in its application (i.e. not limited to digital activities), the international groups with activities in France should review their operating models in light of this decision. This analysis will have to be carried out on a case-by-case basis, taking into account in particular this possible modification made by the MLI to the conventional definition of dependent agent, depending on the status of the reservations and the state of progress of the MLI ratification procedure in the other state.

Indeed, this decision could be applied on a situation in which an American company is involved and as France has notified that the double tax treaty signed with the USA is liable to the MNI, even if the United States have not signed the MNI, we advise to review your business model considering this caselaw.

Our legal team can assist you in securing your business model in light of this case-law.

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Further information :

- French Administrative Supreme Court (''Conseil d'Etat'') 11/12/2020 n° 420174
- Cour d'Appel de Paris 25/04/2019, 9ème chambre, 25/04/2019, 17PA03067 dit « arrêt Google »
- Multilateral Instrument (MLI) OECD