



The potential reclassification of a foreign company's French activity as a permanent establishment in the light of recent case law in France and OECD standards

1/ PERMANENT ESTABLISHMENT FOR CORPORATE TAX PURPOSES:

The tax treaty between France and Germany stipulates: “In the absence of a fixed place of business (within the meaning of Article 2, (1)-7, subparagraphs 1 and a, the same Article 2, (1)-7 of the treaty) provides in its subparagraph c that the use of an agent characterizes the existence of a permanent establishment when this agent possesses and habitually exercises the powers necessary for the conclusion of contracts in the name of the enterprise, unless the activity of this agent is limited to the purchase of merchandise for the said company”.

However, a recent nuance was introduced by the French Council of State in the “*Conversant*” judgment dated December 11, 2020 (*CE 11/12/2020 n° 420174, Conversant International Ltd*). In this judgment, the French Council of State modifies its interpretation of tax treaties with regard to the use of the OECD commentaries to expand the notion of permanent establishment to a number of situations involving the digital economy, with more application possibilities.

According to this decision, a person who habitually, even if it doesn’t formally conclude contracts on behalf of the parent company, decides on transactions which the German company validates and thus commits itself through them, must now be regarded as exercising such powers.

When all the tasks necessary for the conclusion of contracts or the preparation of tender documents are performed by employees of the German company present in France and the German company merely validates the contract by signing it automatically, there is a permanent establishment in France.

There is therefore a clear risk of reclassification as a permanent establishment for French corporate income tax purposes if the employees are significantly involved in gathering commercial information, preparing calls for tender and participating in commercial negotiations, even if the contracts are subsequently signed by management in Germany.

The French Council of State thus specifies that *"In order to have a permanent establishment in France (within the meaning of the above-mentioned provisions), a company resident in Ireland must either have a fixed place of business [...], or have recourse to a non-independent person who habitually exercises powers in France which enable him to engage it in a commercial relationship relating to the operations constituting its own activities. A French company must be regarded as exercising such powers, as is clear from paragraphs 32.1 and 33 (relating to Article 5, 5°) of the commentaries to the OECD Model Convention published on 28 January 2003 and 15 July 2005 respectively, if, on a regular basis, even if it does not formally conclude contracts on behalf of the Irish company, it decides on transactions which the Irish company merely endorses and which, when so endorsed, are binding on it.*

This decision of the French Council of State could be a first step in a process of unilateral application by France of the extensive definition of permanent establishment proposed by Article 12 of the OECD Multilateral Instrument, a provision adopted without reservation by France, but sometimes without reciprocity, as many other States (such as Ireland). This article recognizes the status of permanent establishment of an enterprise to any person who, acting as a dependent agent of the enterprise, habitually enters into contracts or habitually plays the principal role in the conclusion of contracts which, on a routine basis, are entered into without significant modification by the enterprise.

2/ PERMANENT ESTABLISHMENT FOR VAT PURPOSES:

In terms of VAT, the criteria for reclassification as a permanent establishment are still different. In fact, according to the French Council of State judgment “*9th and 10th ss-sect. 17 June 2015, n° 369100, Sté Printing Pack BV*”:

- The establishment has permanent material and human resources in France
- This permanence must allow him to carry out his activity with a certain degree of autonomy, so that the establishment is considered the focal point of the services provided.

It can be concluded from this, given that the employees present in France have all the technical means to carry out the maintenance, repair etc. of the medical equipment sold, and given their presence in France, that there is a permanent establishment for VAT purposes.

It should be noted that a specific unit has been created in France (Finance department), with specialized controllers, in order to deal specifically with cases of permanent establishment of foreign companies in France. The subject and the latest developments in case law are treated with the utmost attention. In addition, in the event of reclassification by the administration as a permanent tax establishment, the limitation period concerned (and therefore the tax adjustment period) is extended to 10 years.

We remain at your disposal for any further information on this subject.

Best regards

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