

## **Significant Transfer Pricing Disputes – II Philips France SAS – Administrative Supreme Court Decision**

In a decision dated 19 September 2018, the French Supreme Administrative Court ruled that, in the context of contract R&D services provided by Philips France SAS and charged at cost-plus to a foreign associated enterprise does not by itself suffice to characterize a transfer of profits abroad through transfer pricing.

This decision puts an end to the Philips France SAS litigation case that started in 2014 with a contrary decision by a French Administrative Tribunal. It provides useful clarifications on the application of the cost-plus method and clarifies the rules concerning the burden of proof in transfer pricing matters.

Philips France SAS provided research and development services to its Dutch parent company, Koninklijke Philips Electronics NV. Pursuant to a general services agreement in force between the two companies, the ownership of the intellectual property results derived from these R&D activities was transferred to KPE NV, while Philips France earned a remuneration determined based on the amount of its costs incurred in relation to the provision of these services plus a 10% mark-up.

In the context of a tax audit, the French Tax Administration noted that, in determining the cost base used for computing its remuneration, Philips France deducted the amount of (i) subsidies it received from the French government for business investment projects; and (ii) R&D tax credit refunds.

### **1. Administrative Tribunal of Montreuil**

The resulting tax dispute was brought by Philips France before the Administrative Tribunal of Montreuil. On 1 July 2014, the Tribunal ruled in favour of the FTA, concluding that a transfer of profits had taken place because the deduction was not justified by a master agreement, and that the burden of proof was on Philips SAS but the company did not demonstrate that there was a return at least equal to this advantage provided to Dutch parent company.

### **2. Administrative Court of Appeals of Versailles**

Philips France appealed the decision of the Administrative Tribunal before the Administrative Court of Appeals of Versailles. The Administrative Court of Appeals decided in favour of Philips France, considering that the FTA had not met its burden of proof of an alleged transfer of profits from France to the Netherlands, given that the comparables provided by the FTA were not valid terms of comparison, since they were not from the same industry and/or were not independent enterprises.

### **3. French Supreme Administrative Court (Conseil d'Etat)**

The FTA brought the case before the French Supreme Administrative Court. The FTA did not challenge the comparables, but rather claimed that (i) the deduction of the subsidies from the cost base was sufficient to characterize a “price lowering” leading to an indirect transfer of profits within the meaning of article 57 of the French tax code so that no

comparability analysis was needed; and (ii) the sole purpose of the comparables in this case was to corroborate the finding that the 10% mark-up rate provided under the general service agreement was at arm's length.

#### **4. Conclusion**

The Philips decision rendered by the French Supreme Administrative Court, which is final and cannot be appealed by the FTA, is interesting due to the reasons below:

- The aim of transfer pricing regulations is to ensure that prices are compliant with the arm's length principle.
- Mechanical application of the cost-plus method does not necessarily conform with the arm's length principle.
- During tax audits, the burden of proof does not necessarily lie with the tax payer, Tax Authority may be required to demonstrate that a price lowering or a price augmenting had taken place.
- For transactions involving cost-based methods it is important to;
  - o Determining a pricing clause in the intercompany agreements,
  - o Determining mark-up and cost base which constitute the price of a service in the pricing clause of an intercompany agreement,
  - o Preparing a comparability analysis to support the price determined in the intercompany agreement.

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