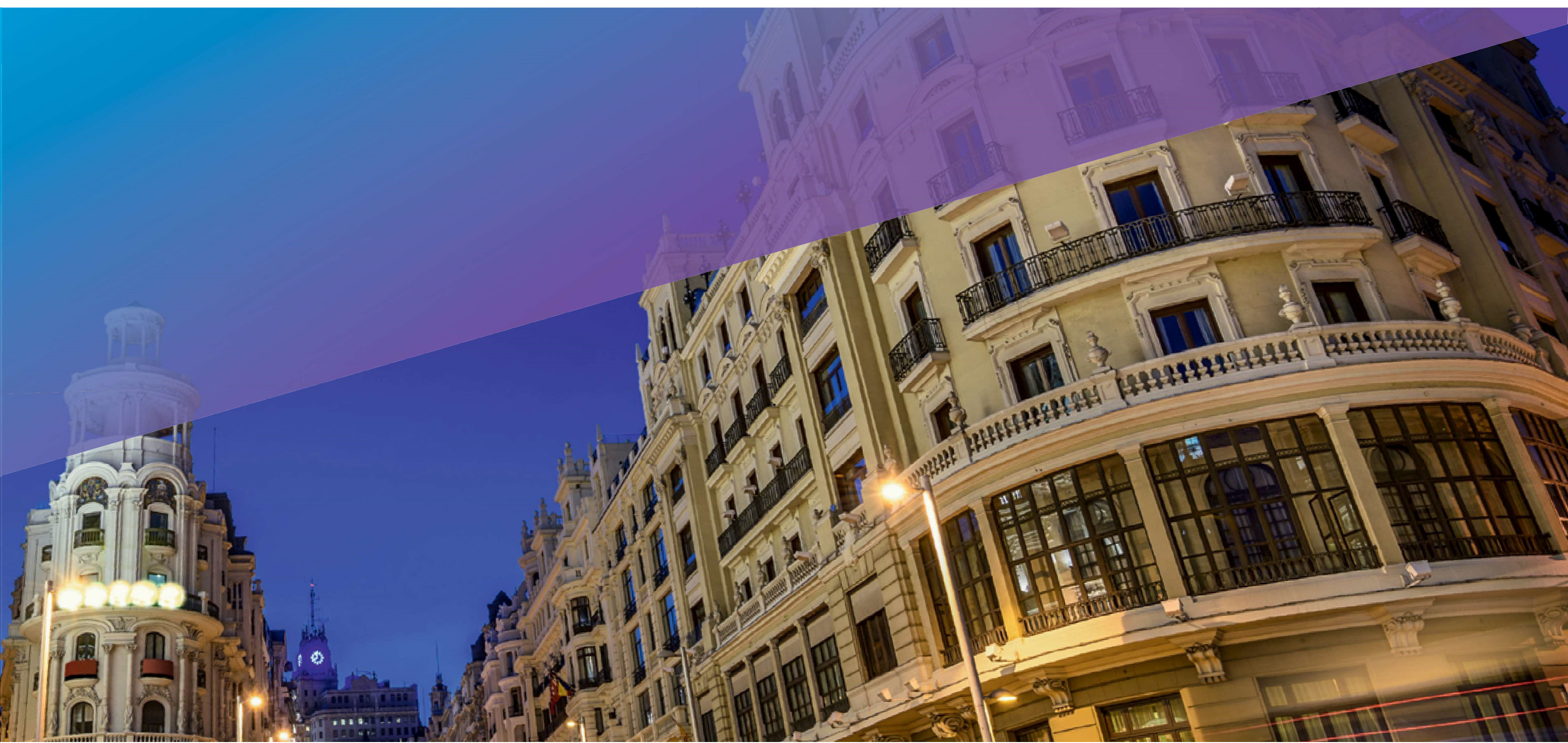

Tax Management International Forum

Comparative Tax Law for the International Practitioner

Income Tax Consequences for Foreign Service Providers

In this issue of the International Forum, leading experts from 18 countries and the European Union provide their perspectives on the income tax consequences faced by foreign service providers that have no permanent establishment in a country but are providing services to its residents. The issue addresses services that may be provided by an individual (other than in the capacity of an employee) as well as services that may be provided by an enterprise, such as technical support.

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THE TAX MANAGEMENT INTERNATIONAL FORUM is designed to present a comparative study of typical international tax law problems by FORUM members who are distinguished practitioners in major industrial countries. Their scholarly discussions focus on the operational questions posed by a fact pattern under the statutory and decisional laws of their respective FORUM country, with practical recommendations whenever appropriate.

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Pascal Faes
NautaDutilh, Brussels

Income Tax Consequences for Foreign Service Providers

Topic

What are the income tax consequences in your country for foreign service providers with no establishment in your country providing services in your country/to your country's residents? (This includes providers of both personal services and other services that might be provided by an enterprise, such as technical support, but does not include services provided in the capacity of an employee.)

Questions

I. Under your country's domestic law what is the threshold of activity (either in terms of length of time, size of project, or otherwise) at which your country considers a nonresident service provider to be fully taxable and requires a tax return to be submitted? Does the threshold, or do other requirements of filing, differ depending on (i) the nature of the services provided; (ii) the nature of the service provider; (iii) length of time the services are provided; or (iv) whether the services are provided in your country or elsewhere?

II. How does your country protect itself to guarantee that a required return or filing would be made, and tax be paid? Does the country require withholding as an advance payment of tax, does it require actual advance payments, or does it have another requirement? What is the rate of withholding if required? Is this a different rate from the rate at which withholding would be required if the nonresident service provider were below the full taxability threshold? If the amount withheld equals the liability, is a return excused? On the other hand, if the withholding either exceeds or is less than the required tax, what is the service provider's obligation (or opportunity) to equalize the amount paid and the amount withheld?

III. Until the threshold that you described above in I. is reached, how are services performed within your country taxed—by way of a final withholding tax or otherwise? What are the rates of tax involved? If tax is imposed by way of final withholding, is this imposed on the gross amount or is the gross amount somehow reduced to take account of expenses incurred by the service provider? In particular, if a service provider is reimbursed for expenses, is that reimbursement considered to be part of the "gross amount" of the services fee?

IV. Please describe any relevant mechanics relating to the procedure or procedures identified in III. (for example, what is the withholding obligation of service recipients; what is the liability of service recipients that do not withhold if they are required to; is there a requirement to appoint a tax agent; if what would be the final liability should be less than amounts withheld, is there a method of claiming a refund; on the other hand, if the amount withheld is deficient, what is the foreign service provider's obligation).

V. Please indicate what would be the position if, instead of providing the services directly, the foreign service provider subcontracts the provision of services in your country. In particular, would the engagement of a subcontractor automatically be

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considered to represent a presence of the foreign service provider in your country? If not what would distinguish the circumstances in which such a presence would be created from those in which it would not?

VI. Are there any exceptions – for example, higher tax, lower tax, exemptions, etc.—to the general system described above, for example, for foreign service providers located in particular jurisdictions (e.g., tax havens, territories like the EU/EEA), or for provision of services in certain locations?

VII. What other, non-tax requirements need to be met by foreign service providers supplying services in your country in these circumstances (e.g., business registration requirements; visas authorizing employment or general work; bank accounts; etc.). Do government agencies responsible for those areas coordinate with your country's tax authority to ensure both proper compliance and proper tax reporting based on those factors?

VIII. How are the positions under I. and III. altered by your country's tax treaties? In particular, if the treaty concerned does not allow source country taxation of the services income concerned, may payments be made without deduction of tax? If not what procedures must be followed to obtain a treaty-based refund? (Provisions dealing with specific services such as directors' services and those performed by artists and athletes/ performers can be ignored, as can the circumstances in which a treaty provides a specific formula for determining the taxation threshold —- for example, a monetary threshold).

FRANCE

Thierry Pons
Tax lawyer, Paris

I. Domestic Law Threshold for a Nonresident Service Provider to Be Fully Taxable and Required to Submit a Tax Return

The comments in this paper relate only to direct taxation. Indirect tax rules, in particular value added tax (VAT) rules, which generally permit a large degree of source-country taxation, are outside the scope of the paper and will not be addressed. The paper focuses mainly on the provision of services by a foreign corporation: only limited attention is given to service providers who are individuals and to income from services that does not constitute business income.

The provision of services by a nonresident service provider can be taxable in France under three sets of rules:

- First, Article 164 B of the French Tax Code ("FTC") defines French-source income to include, in particular, income from commercial activities carried on in France, but also other professional income derived in France, including income from the supply of the services of athletes and artists, and income from patents and other intellectual property paid by a French payer.
- Second, Article 209 of the FTC, which defines the scope of corporate income tax ("CIT"), permits the taxation of a foreign corporation if the corporation can be regarded as "carrying on a business" in France.
- Third, a nonresident provider of services may be subject to withholding tax on its French-source income. The withholding tax provided for by Article 182 B of the FTC applies whether or not the nonresident beneficiary of the income concerned is subject to directly assessed tax in France: the withholding tax is an independent tax, separate from directly assessed tax, and is not therefore, technically, simply a way of guaranteeing the payment of directly assessed tax. The withholding mechanism is discussed in II., below.

As further explained below, France, as the source country, is in principle prohibited from imposing either directly assessed tax or withholding tax on business profits derived by a service provider resident in the treaty partner country where a tax treaty applies, if the service provider is not physically established in France and does not have a dependent agent in France (the relevant treaty rules are discussed in VIII., below).

As regards France's domestic CIT rules with respect to business income, under Article 209-I of the FTC, "the income liable to corporation tax is computed by taking into account only income generated by enterprises carrying on a business in France, as well as French-source income as defined in Article 164 B of the FTC and income the taxation of which is allocated to France in accordance with the provisions of a tax treaty."

It is important to understand that, in accordance with this definition, France's nexus rules are unlike those of most other countries in that France applies a territorial approach to assessing CIT (It should be noted that this "territorial" approach applies only to entities subject to CIT; it does not apply to individuals, who are taxed on their worldwide income).

Because of this territorial approach, the criteria used to determine: (1) whether *a nonresident corporation* is taxable in France; and (2) whether *a French corporation subject to CIT* is taxable in France on its foreign-source income or whether such income is to be excluded from the territorial base, must be applied symmetrically. Thus, for example, the wider the range of circumstances in which foreign corporations are regarded as deriving income from electronic commerce that is subject to French tax, the wider the range of circumstances in which French companies generating profits abroad from the same activities or in the same situations would be regarded as deriving income outside the French territorial nexus (or as incurring losses that are not deductible for French tax purposes).

In its reliance on a combination of the fixed place of business and dependent agent criteria, the concept of "carrying on a business in France," as used in France's domestic CIT law, is quite close to the corresponding tax treaty approach. However, French case law has extended the concept to encompass situations in which the foreign corporation has no such fixed place of business or dependent agent, but carries out a "full commercial cycle" in France.

The "full commercial cycle" concept derives from a 1944 court decision (in which purchase and sale transactions carried out outside France were excluded from the territorial scope of French taxation) and was

subsequently incorporated into administrative guidelines. The concept refers to situations in which a non-resident carries out a significant number of business operations that, taken together, constitute a comprehensive business in France (one transaction or only a few transactions would not be sufficient). The classic example of a full commercial cycle is an operation of buying and selling goods or services in France.[1] Another well-known example is furnished by the case of a radio station located in Monaco but receiving advertising fees for transmitting radio broadcasts received by French listeners, a technical precursor of the "GAFA" model.[2]

There is more recent case law that deals with income from the provision of services related to a building site abroad, which was regarded as outside the French territorial nexus.[3] In a number of cases, the concept was, however, restricted by requiring that the activity at issue be considered in "dissociation" from the corporation's main activity,[4] an approach that, where it entails the requirement that there be no involvement of the head office, in practice significantly undermines the full commercial cycle concept.

What does emerge clearly from all these cases, is that to qualify as a full commercial cycle, the activities concerned must have enough substance, continuity and regularity to constitute a taxable business in France. Thus, "casual" transactions should not qualify, even though there is no clear delineation of the point at which casual transactions become regular.

It is important to note that the scope of the full commercial cycle concept, which technically can produce conclusions that diverge from those resulting from the application of more usual permanent establishment ("PE") criteria, remains largely confined to theoretical realms. As already noted, the concept applies only in a non-tax treaty context, because it is not compatible with the treaty criteria, which require a physical presence in France, whether through a fixed place of business or a dependent agent.

Furthermore, the physical presence of teams on site was a factor that was considered in the above cases concerning building sites, which further limits the autonomy of the concept (though the radio station case referred to above probably has more current relevance). That being said, the full commercial cycle concept would seem to be highly relevant in analyzing the treatment of transactions effected through the internet (though again only in a non-treaty context).

Turning to the more traditional PE criteria used in a tax treaty context, the French administration has indicated in the past that the presence of a server does not by itself constitute a PE and looks mainly at the presence of staff or other agents.[5]

As in other countries, a hot issue in France is whether a foreign corporation "commercializing" goods or services through the Internet should be subject to French CIT, where the corporation has not registered a taxable PE in France, but carries out activities in France, either through a presence that is represented as being auxiliary and preparatory, or through dependent agents located in France.

In these latter circumstances, the relevant question is whether or not such presence constitutes a PE in substance. As such, it is not really a question relating to territoriality principles described above, but a question of fact regarding the substance of the French activities in terms of the traditional PE criteria. Similar questions can arise in relation to transfer pricing, when services are provided by a foreign corporation and a related entity of the foreign corporation located in France and acting as an agent is involved in the process.

These issues, which are at the center of the BEPS discussions, are highly sensitive, and, since 2009, the French government has been under public pressure to take steps to counter what is widely perceived as aggressive tax optimization and even fraud—albeit that much of this public pressure unfortunately fails to make a clear distinction between legitimate and necessary tax optimization (as accepted by the Court of Justice of the European Union ("CJEU") itself in a landmark case[6]) and the kind of aggressive optimization that relies on artificial structures.

It is interesting to note that, quite independently of the OECD's BEPS initiatives (which will not be discussed here since they are not purely a question of French domestic law), a few weeks ago in the most recent Finance Bill (i.e., the Finance Bill for 2017), the French Parliament tried to introduce a provision (proposed Article 209 C of the FTC) that would in essence have functioned as a kind of reverse controlled foreign corporation ("CFC") mechanism: instead of taxing the foreign income of CFCs or other foreign entities controlled by French resident entities (as provided for by Article 209 B), the proposed measure would have taxed foreign controlling entities on income deemed attributable to their French agents.

In summary, proposed Article 209 C of the ITC was aimed at a foreign corporation, whether or not established in France, carrying on activities consisting of sales of goods or supplies of services on the French market, through a dependent agent or a website, when "there are serious reasons" to consider that the activities of the foreign corporation had the purpose of avoiding or reducing tax due in France. When applicable, Article 209 C would have allowed France to impose the tax on the income arising from such activities that would normally have been due in the absence of an artificial arrangement.

There was, however, no explanation as to what the tax normally due would have been and why, if the tax would normally have been due under other ordinary provisions of the FTC, these existing ordinary provisions were not sufficiently effective to tax the foreign entity, without a provision as ambiguous provision as Article 209 C having to be implemented. The proposal also indicated that the provision could be used in a tax audit based on a decision of the tax authorities to apply the presumption with respect to the taxpayer under audit, thus leaving a great deal of autonomy to the administration in deciding whether or not to implement the provision.

Unsurprisingly, this new provision (originating as it did in an isolated initiative of the Parliament, and voted contrary to the will of the government) was rejected and annulled by the French Constitutional Council before coming into force, based on the principle that Parliament cannot surrender to the tax administration the constitutional prerogative, which is its alone, to define the scope of taxation: apart from

the fact that it was based on a number of apparently very vague concepts, proposed Article 209 C was worded in such a way as to leave too great a power of interpretation to the tax administration.

Although it was not necessary for the Constitutional Council to express its opinion on all the constitutional principles involved (one constitutional reason to annul the law being sufficient), as worded, proposed Article 209 C appeared also to raise other difficulties in relation to equality principles (equality with respect to taxation and with respect to the law), and the principle of certainty of rights, both provided for by the 1789 Declaration of Human and Citizens Rights, which remains part of the French Constitution (and remains impressively apposite and effective, even after more than two centuries, especially now that it can be resorted to in litigation).

Furthermore, implementing a reverse CFC mechanism only applicable to foreign entities and extending the territorial nexus in the situations in which the mechanism was applicable would have created an asymmetry with the territorial approach applied to French-based corporations and would have created substantial tax discrimination (or reverse discrimination) problems.

II. Domestic Law Methods for Ensuring That a Return Is Filed and Tax Paid

To combat fraud in the form of having a physical presence in France but not recognizing the income attributable to such presence, the French tax administration can have recourse to a special audit procedure (L 16 B of the Tax Procedure Code), which, in a departure from normal practice, allows unannounced, on site audits, after prior authorization has been obtained from a judge, based on suspicion of the existence of fraud with respect to tax. The procedure allows the administration to seize all documentation necessary to establish the nature and substance of the activity on French soil. The number of these L16B procedures has substantially increased over the years and foreign service providers with some form of presence in France are in the focus of attention.

Apart from this audit procedure, withholding tax is imposed on payments made to nonresident service providers that are not established in France under the widely-drawn provisions of Article 182 B of the FTC. An anti-avoidance mechanism targeted at foreign "rent-a-star" entities may also apply to both resident and non-resident service providers.[7]0

Under Article 182 B of the FTC, payments made by a French resident professional or corporation to a nonresident provider of services are subject to withholding tax at the rate of 33.33% (15% in the case of payments to athletes). No withholding tax applies to payments made by individuals acting in a private capacity (i.e., no "B-to-C" services are subject to withholding tax).

The withholding tax is imposed on gross payments made in consideration of services furnished or used in France, which gives the tax a wide scope. Article 182 B of the FTC also applies to income derived from non-business activities, such as income from patents and other intellectual property and income deriving from sporting activities (artistic activities are dealt with in a separate article, Article 182 A *Bis*).

France's tax treaties generally prevent the imposition of this withholding tax, under their articles dealing with business profits (which require an enterprise of the treaty partner country to have a PE in France for the enterprise's business profits to be subject to French source country taxation), or royalties (though some of France's treaties allow withholding tax to be imposed on royalties, at a reduced rate).

Apart from this general withholding tax on income from the provision of services, Article 155 A of the FTC also allows France to tax remuneration paid by a French payer to a foreign entity for services effectively rendered by a French resident, when the foreign entity is controlled, directly or indirectly, by the French resident (for example, in the context of a "rent-a-star" structure), which hires an artist or athlete as an employee and receives the fees for the artist's or athlete's performances. The income received by the foreign entity in these circumstances is taxable in the hands of the French resident, unless the French resident can establish that the entity's activity does not essentially consist in the supply of the French resident's own services, whether in France or abroad, and/or that the service supplied by the foreign entity itself constitutes the main service supply.

Article 155A also applies to a nonresident supplying services in France (even, in principle, where that nonresident is a corporation) that controls a nonresident entity receiving remuneration for services supplied in France by the nonresident service provider (i.e., Article 155 A applies to nonresidents only with respect to their French-source income, but does apply to such income even where the transaction giving rise to it is an isolated transaction).

Under these provisions, the person receiving the remuneration is jointly responsible for the tax due.

III. Method of Taxing Services Income When Domestic Law Threshold for Full Taxability Is Not Reached

Article 182 B withholding tax applies to all gross payments made by a French resident professional or corporation to a foreign beneficiary, whatever the amount of the payment concerned.

The status of the withholding tax with respect to directly assessed tax remains somewhat ambiguous, though it has been clarified to a certain extent by recent case law.[8] When the provisions of Article 182 B of the FTC were voted on in 1976, it was indicated during the parliamentary debate that the intended function of the withholding tax was to guarantee the payment of directly assessed tax, which could have confined the scope of the withholding tax to situations in which directly assessed was due. In these circumstances, business income derived by nonresidents not carrying on a business in France (i.e., having no fixed place of business and no agent in France and not carrying out a full commercial cycle in France in satisfaction of the criteria laid down by French domestic law) would not have been subject to withholding tax.

However, in a July 30, 1997 decision,[9] the High Court held that the withholding tax could be imposed, irrespective of whether directly assessed tax was due.

This left open the question of whether the withholding tax could be credited against directly assessed tax due or whether it constituted an entirely independent tax. It has now been confirmed by the High Court (in a February 17, 2015 decision[10]) that the withholding tax is not a final tax and that, when there is a corresponding directly assessed tax liability, the withholding tax paid can be credited against the directly assessed tax due.

In practice, the above situation would only arise for taxpayers subject to progressive income tax on their French-source non-business income (for example, income from patents and other intellectual property, income from the activities of athletes, and pension income), as defined in Article 164 B of the FTC as discussed in I., above. The minimum progressive rate of directly assessed tax applicable to nonresidents is 20%, but this minimum rate does not apply if the taxpayer is able to establish that the application of the progressive rates to its worldwide income would result in an effective rate lower than 20%. Directly assessed tax amounts of less than 305 euros are not due.

Where the application of the progressive rates to net income (after the deduction of related expenses) results in a tax burden lower than the withholding tax burden, the excess withholding tax will be refunded. The withholding tax is thus neither a minimum nor a maximum tax.

In principle, the position would be different for a nonresident in receipt of business income, since, assuming the nonresident is not established in France, there would be no CIT or directly assessed tax liability against which the withholding tax paid could be credited (in the absence of a business carried on in France). In this context, the withholding tax still operates as a separate tax, not merely as a guarantee of payment. Nonetheless, a nonresident in these circumstances should be able to claim a refund if the withholding tax on gross income is higher than the tax that would be due on net income, taking into account related expenses.

IV. Mechanical and Procedural Issues Relating to Taxation of Services Income When Domestic Law Threshold for Full Taxability Is Not Reached

Payments made by a French resident to a nonresident service provider must be reported in the annual return of payments made to service providers (including resident and nonresident service providers) and penalties equal to 50% of payments made can be imposed in cases of failure to report.

The service recipient is considered a "withholding agent" with respect to payments to a nonresident service provider and must pay the withholding tax due before the 15th of the month following that in which the payments are made. In cases of failure to withhold, a 9000 euro penalty can be imposed and the administration can deem the amount paid to be a net amount and compute the withholding tax due on the deemed gross amount (gross-up).

A withholding agent must either withhold the full amount of the applicable withholding tax or obtain documentation upon which it may rely to apply a reduced or zero rate of withholding tax.

V. Difference If, Instead of Providing the Services Directly, the Foreign Service Provider Subcontracts the Provision of Services

Where a nonresident service provider subcontracts with a local agent, the local agent is, of course, taxable on the related income received from French clients with which the agent contracts in his/her own name. If the agent is a dependent agent and contracts in the name of the foreign supplier (albeit this is not actually a subcontracting arrangement) the agent may be regarded as a PE of the contractor where the usual criteria are satisfied.

A more difficult question to answer—and one that currently often arises as a practical matter—is how a contractor and an independent agent should be taxed where the income received by the agent from clients is, even partially, paid back to the contractor, as will generally be the case. The focus will normally be on transfer pricing—the functions effectively performed by the agent and the appropriate consideration for intangibles—but, in some circumstances, the tax administration may argue that the foreign contractor is, in fact, established in France, which would require a requalification of the agent as being dependent. Even in the latter situation, the real question is a transfer pricing question: what income should be allocated to what party for what functions?

VI. Exceptions to the General System

The EU Interest and Royalties Directive prohibits the imposition of withholding tax on royalty payments made between related entities (25% control is required) resident in the European Union.

The rate of withholding tax is increased from 33.33% to 75% for payments made to beneficiaries located in "non-cooperative" countries.[11]

VII. Other, Non-tax Requirements Applying to Foreign Service Providers

As noted at I., above, the presence of premises and staff in France point to the existence of a French PE except when the activity is limited to auxiliary and preparatory functions. The use of premises in France must be reported to the tribunal of commerce, and triggers a liability to French local taxes related to premises (even if auxiliary). The presence of staff in France must also be declared for social security purposes. Such physical presence in France does not necessarily constitute a fixed place of business when the activity in France is limited to preparatory and auxiliary functions, but this exception is limited in scope. The French tax administration has undertaken numerous audits to examine the presence of nonresident enterprises in France, often using the on-site L16 B procedure to appropriate evidence regarding a potential taxable presence.

VIII. Difference If There Is an Applicable Tax Treaty Between France and the Foreign Service Provider's Country of Residence

France's tax treaties generally follow OECD guidelines and the definition of a PE in those treaties is normally based on the traditional fixed place of business and

dependent agent criteria and thus excludes situations in which a nonresident enterprise carries out a "full commercial cycle," which are not relevant in a treaty context. The treaties prohibit the imposition of source country tax (withholding tax) on business profits derived by an enterprise resident in the other country, where the enterprise does not have a PE in the source country. Some of France's treaties permit the imposition of withholding tax on royalties (albeit at a reduced rate), in which case the principles discussed in II. and III., above, may apply. In all cases, a French payer of income to a nonresident must obtain sufficient documentation to establish that the nonresident qualifies for benefits under the applicable treaty.

Since France has an extensive network of tax treaties, treatment in accordance with OECD principles will apply in most circumstances. Non-treaty situations are the exception and generally arise where a tax haven is involved, but it is worth noting also that Denmark has denounced its treaty with France (for reasons related to the treatment of pensions) and is one of the few OECD countries (perhaps the only OECD country) in relation to which French domestic law, rather than treaty rules, will determine the tax treatment.

All that being said, for the reasons explained above, when and how a nonresident service provider should be taxed in France remains a highly sensitive issue, especially when the service provider has some form of presence in France (through an agent, a subcontractor, or a presence that is represented as being preparatory or auxiliary in nature).

By way of a general conclusion, it is worth emphasizing that the French domestic law territoriality concept is wide in scope and the best approach is to examine the wording of the applicable treaty (if any) regarding the definition of a PE and auxiliary activities. Based on current law and treaty principles (and subject to any change in the OECD approach), where a foreign service provider has absolutely no physical presence in France and no agent in France, income derived by the service provider should clearly be outside the scope of French taxation. Other situations will require the carrying out of a functional and transfer pricing analysis based on the relevant facts.

Discussions revolving around source of income issues did not begin with the Internet[12]—they have a long history, dating back to before the creation of the Internet, in the context of the tax treatment of intangibles and the attempts of developing countries to retain a taxing nexus with respect to income generated in their markets, especially in relation to business-to-consumer activities. Doubtless, developing countries will be following the ongoing BEPS discussions with a great deal of interest—in particular, any amendment to the source of income rules that could arise from such discussions.

NOTES

[1] High Court May 22, 1963 n°46870.

[2] GAFA is an acronym coined by the French media for U.S. tech. giants, Google, Apple, Facebook, Amazon.

[3] High Court May 17, 1989 n°34380.

[4] High Court Feb. 5, 1968 n° 62333.

[5] Ministerial answers *De Chazeaux*, 1998 and 2001; note, however, that these answers are no longer commented on or referred to on the French tax administration's web site.

[6] *Cadbury Schweppes* EUCJ Sept. 12, 2006 n°196/04.

[7] FTC, Art. 155 A.

[8] CE Feb. 17, 2015 n° 373230.

[9] High Court July 30, 1997 n°169179.

[10] High Court Feb. 17, 2015 n° 373230.

[11] "Non-cooperative" countries are specified in a list published every year by the tax administration. A non-cooperative country is a non-EU Member State that:

- Has been subject to OECD review;
- Has not concluded a tax treaty with France allowing for the full exchange of information for purposes of applying the Contracting States' tax legislation; and
- Has not concluded such treaties with at least 12 other countries.

The last list published by the Administration includes Botswana, Brunei, Guatemala, Marshall Islands, Nauru, Niue, and Panama.

[12] *See* Report to IFA Congress: *Taxation of Income Derived From Electronic Commerce*, Vol. 86a, San Francisco (2001).