2 November 1976

INCOME TAX PRACTICES MAINTAINED BY FRANCE

Report of the Panel presented to the Council of Representatives on 12 November 1976
(L/4423 - 23S/114)

1. The Panel's terms of reference were established by the Council on 30 July 1973 (C/M/89, paragraph 7):

> "To examine the matter referred by the United States to the CONTRACTING PARTIES pursuant to paragraph 2 of Article XXIII, relating to income tax practices maintained by France and to make such findings as will assist the CONTRACTING PARTIES in making the recommendations or rulings provided for in paragraph 2 of Article XXIII."

2. The Chairman of the Council informed the Council of the agreed composition of the Panel on 17 February 1976 (C/M/112, paragraph 17):

Chairman: Mr. L.J. Mariadason (Counsellor, Permanent Mission of Sri Lanka, Geneva)

Members: Mr. W. Falconer (Director of Trade Policy, Department of Trade and Industry, Wellington)
Mr. F. Forte (Professor of Public Finance, University of Turin)
Mr. T. Gabrielsson (Counsellor of Embassy, Permanent Delegation of Sweden to the European Communities, Brussels)
Mr. A.R. Prest (Professor of Economics of the Public Sector, London School of Economics)

3. In the course of its work the Panel held consultations with the United States and France. Back

9. Under the territoriality rule as applied by France, profits generated by undertakings operated abroad are exempt from French taxation. On the other hand, a French company is not entitled to any foreign tax credit and cannot deduct losses suffered abroad, apart from exceptions specified below.

10. If a subsidiary is a purely fictitious corporation located abroad and all its activities are directed from France, tax is levied in France on total profits for the reason that all corporations, regardless of nationality or location of the statutory head office, which have an effective management headquarters in France are taxable in France.

11. Ninety-five per cent of dividends from

Article XVI:4, which was proposed by France, included the following items: (c) "The remission calculated in relation to exports, of direct taxes … on industrial or commercial enterprises" and (d) "The exemption in respect of exported goods of … taxes, other than … indirect taxes levied at one or several stages on the same goods if sold for internal consumption …".

Effects of the territoriality principle as applied by France for taxation of foreign profits

18. The representative of the United States pointed out that France followed the territoriality principle of taxation, and that as a result, did not tax the export sales income of foreign branches or foreign sales subsidiaries of domestic manufacturing firms. Taxes on such income were for the most part permanently forgiven rather than merely deferred. He stated that the exclusion apparently extended to foreign source income from activities carried out by a French selling corporation through its own agents or employees abroad even without a foreign permanent establishment, as income from transactions which were separate from the corporation's French operations and which constituted complete commercial cycles outside France were excludable. The representative of the United States argued that these provisions, and relaxed intercompany pricing rules and other practices in relation to export transactions, created a distortion in conditions of international competition in that they afforded remission or exemption of direct taxes in respect of exports in violation of France's commitment as a contracting party under Article XVI:4. The permanent exemption could be freely used by the domestic manufacturing firm. The relative tax burden on the sales of products for export as against domestic sales was lower as a result of the remission.

19. The representative of the United States argued that, by organizing a foreign branch or subsidiary in a low-tax country, a French manufacturing firm could enjoy the low-tax rate on that portion of the total export sales income which was allocated to the foreign branch or foreign sales subsidiary, that the amount of export sales income allocated to foreign sources was generally substantial, that under the French system the right to tax foreign income was given up. He concluded th/F8 11 Tf(income) TjET/F8 1 0

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be taxed both at home and abroad if there was no double taxation convention because France had no crediting device to avoid double taxation.

23. The representative of France said that the territoriality rule was virtually inoperative in respect of tax havens. Since undertakings that used such facilities did so mainly through subsidiaries, or at least through corporations having a separate legal personality, if they relied on tax haven subsidiaries for tax evasion purposes, they had no interest in distributing the dividends. The representative of France added that French companies had far fewer possibilities than United States enterprises for making use of subsidiaries established in tax havens and that the rules relating to inter-company pricing and the fight against misuse of the law were fully applicable. French companies were required under the foreign exchange regulations to obtain permission from the Bank of France for any transfer

27. The representative of France said that the arm's-length principle was basic to its system but that, in the case of related enterprises, the whole marketing process had to be taken into account. He stated that if the marketing company suffered a loss it would be

income of exporting firms from direct taxes, must be found to constitute even clearer subsidies in violation of Article XVI:4. Whereas the DISC legislation provided only a deferral, the tax practices of France amounted to a remission or exemption. The United

37. Commenting on this, the representative of the United States said that non-deduction was of minor significance, as foreign losses were not deductible only if they were incurred by undertakings operated outside France and stressed that during the start-up phase, during which losses were expected, the undertakings could be operated from France.

Medium-term credits; inflation levy; exporters' card

38. The representative of the United States complained that an export company which extended medium-term credit on export sales was entitled to a special deduction for a reserve to cover the risks of extending credits abroad, and pointed out that if the credit were repaid by instalments, the French corporation would have the use of the incremental cash payments attributable to the deferral of tax for a considerable period of time.

39. The representative of France replied that this provision was adopted in 1960 and had not been subject to criticism until now. He said that, in fact, it only concerned sales of capital goods, and that the flat-rate reserve for medium-term foreign credit was in no way a breach of the GATT rules.

40. The representative of the United States also took up the French Inflation Levy which imposed a temporary and refundable tax on gains in order to curb inflation; the taxpayer had the right to exclude any export income from the calculation of the tax base for this purpose. He argued that whatever the intent of the legislation, its result would be to create a price differential.

41. The representative of France explained that the levy had not been made applicable to exports because it was designed to combat price increases in France and because price formation internationally was governed by factors other than those operating in the French market. He added that the inflation levy had never been applied in practice.

42. France denied a number of contentions relating to the system of exporters' cards which had been in force from 1957 to 1973.

Bi-level pricing

43. Referring to the provision in Article XVI:4 relating to the sale of products for export "at a price lower than the comparable price charged for the like product to buyers in the domestic market", the representative of the United States argued that, if the Panel on DISC found that when the CONTRACTING PARTIES agreed that exemption of direct taxes in respect of exported goods was generally to be considered a subsidy within the meaning of Article XVI:4 they intended to create a presumption that such tax practices resulted in lower export prices in relation to domestic prices, and if the DISC Panel went on to find that the deferral of taxes on export sales income provided by DISC resulted in lower export prices, then the Panel on French Tax Practices had likewise to find that the tax practices of France, providing for the total or partial exemption of export sales income of exporters located within France, were more likely to result in lower export prices and, therefore, were even more clearly prohibited by Article XVI:4.

44. The representative of France maintained that their

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exporters

B. Article XXIII:2 nullification or impairment of benefits

45. The representative of the United States argued that a prima facie case of nullification or impairment was established where it was determined that the measure complained against violated the General Agreement and that, since the tax practices of France constituted

53. The Panel therefore concluded that the French tax practices in some cases had effects which were not in accordance with French obligations under Article XVI:4.

54. The Panel noted that the allocation of profits between companies and their foreign operations was made in accordance with the arm's-length pricing principle but that there were formal exceptions to this principle and concluded that the benefit would be increased to the extent that arm's-length pricing was not fully observed.

55. The Panel considered that deductions against domestic profits of certain cost and lop1 493.2 680.88 Tm/F8 11