

The French tax administration can check the tax returns and possibly challenge the calculation of the taxes and reassess these taxes. Hereafter you will find the basic information about tax audits:

Who ?

Any legal entity established in France (branches or subsidiaries) may be subject to a tax audit. Please note that individuals may also be subject to tax audits even if it is not the subject of this memorandum.



How ?

The French tax administration will send a letter to the French legal entity notifying them that a tax audit will take place, which years will be audited and which taxes will be audited. Indeed the tax audit may concern all the taxes filed during the period audited or only some of them (e.g. VAT). The letter will set also the date for the first meeting with the tax auditor.

The first meeting should be attended by the legal representative of the company (or one of his duly authorised senior employees), as well as the accountant. The legal representative will briefly explain the company's economic activity to the tax auditor. Most often it will take place on the company premises. During this brief first meeting, the tax auditor will request some documents, maybe explain what he is interested in (e.g. research tax credit, etc.), and set the dates for the next meetings.

The next meetings need only be attended by the accountant. With the tax auditor's agreement, they can take place in the accounting firm's office. The tax audit can last several months (but less than 3 months if the turnover is lower than 777K€ for companies that sell goods, or 234K€ for other companies).

Then the tax auditor will set a last meeting, during which he will explain if he will reassess the French legal entity, or not. A letter will confirm the tax auditor's decision in writing.

Please note that the tax audit may sometimes be conducted without visiting the legal entity. If the tax administration notices discrepancies (e.g. between the data filled in the corporate tax return and the VAT returns) it may send a letter signifying the tax reassessment. The company then has to prove that the reassessment is not valid. In order to avoid this kind of remote audit, returns have to be filed in due time and with all required, and accurate, details.

What ?

The tax auditor may examine the tax returns (corporate tax, business tax, VAT, etc.) as well as all the calculations for these tax returns and the supporting documents. In the case of a general tax audit, especially concerning corporate tax, the tax auditor may request a copy of the general ledger (which must match the accounts filed in France). He can ask to see any accounting document (sales invoice, purchase invoice, expense report, etc.) which would justify the entries listed in the general ledger.

Please note that for the French tax auditor "the form is as important as the substance": even if an expense is clearly in the interest of the company (e.g. reimbursement of an employees' business travel expenses), if it is not supported by a bona fide supporting document (travel agent's invoice, mileage schedule, etc.), the tax auditor may reject the expense and therefore reassess the corresponding corporate tax.

If the French entity cannot present the bona fide justificatory documents, the tax auditor may reject the accounting books in their entirety: in such a case, the tax auditor will estimate the taxable profit himself; the taxpayer will have to prove he is wrong

with supporting documentation. But if the books appear to be quite regular, it is the tax auditor who will have to justify any correction he wants to make to the taxable result declared by the taxpayer.

If the French legal entity records intercompany transactions, it needs to prepare the adequate transfer pricing documentation. Moreover, if this French legal entity has a turnover or balance sheet in excess of €400 million or owns (or is owned by), directly or indirectly, more than 50% of a corporate entity's capital or of a corporate entity's voting shares, established inside or outside of France, that meets this €400 million threshold, this transfer pricing documentation must be made available to the French tax administration at the start of a tax audit. If the required documentation is not made available by this date, or is only partly made available, the tax administration will demand that it be produced, or completed, within a period of 30 days – which can be extended to 60 days upon the taxpayer's motivated request. Failing to comply with this demand will result in a civil penalty of €10,000 per legal entity, per period under audit, or up to 5% of the gross reassessed amount, whichever is greater.

When ?

The three preceding fiscal years may be audited (e.g. for an entity closing its books on 31st December, a tax audit in 2011 may concern FY2008, FY2009 and FY2010).

However :

- If some tax irregularities were carried forward to one of these 3 years, the tax audit may concern all the previous years in which the loss was carried forward (e.g. if the FY2008 books disclose a loss that came from FY2005, then FY2005, FY2006 and FY2007 can be audited in addition) ;
- For duties (e.g. for the sale of goodwill, shares or real estate), the tax audit may concern the 6 previous calendar years, if no return has ever been filed.
- In case of hidden activity, the tax audit may concern the 10 previous years. Please note that if a payroll-only registration ("RFE") or a representation office is re-qualified

afterwards by the French tax administration as a permanent establishment, then it would be considered as a hidden activity and the French tax auditor may reassess the 10 previous years.

End of tax audit

If the French tax administration decides to reassess the French entity, then, after the last meeting, it will send a registered letter describing the contested items and the corresponding tax supplement to be paid. The French legal entity has 30 days – this deadline can be extended to 60 days upon special request from the legal entity – to reply to this letter and present its counterarguments. If it does not reply within this period, then the tax administration will send the tax payment notice. If the entity has produced counterarguments, the tax administration may accept them, in full or partially, and change the reassessment accordingly. If the tax administration does not accept these counterarguments, it will reply to the legal entity's letter. The discussion between the French legal entity and the tax administration may continue before a board ("commission") and possibly in court.

In case of tax reassessment, the tax administration may request the following:

- the tax that should have been paid upfront
- a penalty for late payment (at a rate of 0,40% per month)
- a penalty equal to 10% of the tax due if the concerned tax return has not been filed in due time or has not been filed at all
- a penalty equal to 40% of the tax due if the breach of law was deliberately done
- a penalty equal to 80% of the tax due if the breach of law was done with fraud manoeuvres.

During the tax audit, your chartered accountant or your lawyer can assist you.

Your Chartered Accountant is your best consultant.

Don't hesitate to contact us!