Ferragamo Loses French Transfer Pricing Case on Trademark Costs

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Ferragamo France's negative margin was caused by brand-building efforts and would have required a service charge to the Italian parent company, a French court held in a long-running, high-profile transfer pricing case.

In its June 30 judgment in *SAS Ferragamo France v. Ministre de l'économie, des finances et de la relance* (No. 20PA03601), the Cour Administrative d'Appel de Paris (CAA), one of eight administrative courts of appeal in France, held in favor of the tax administration, authorizing the deemed profit attribution to Ferragamo France's income of €2.3 million for 2009 and €2.2 million for 2010.

"This is the first time that French courts say that the retailer and distributor provides value to the trademark and [intellectual property] owner and should be remunerated for that," Sabine Sardou of BDO Paris told *Tax Notes* July 15. "Before, that argument was only used to reduce a royalty fee."

"The decision is very disappointing for the luxury brand business," Sandra Hazan of Dentons Paris said.

"Lately the French courts hold in transfer pricing disputes that the tax authorities meet their burden of proof, something that seemed almost impossible for the tax authorities in the past," said Elfie Ossard-Quintaine of KPMG Paris.

Ferragamo France was established in 1992 and held by the Italian parent company, Salvatore Ferragamo SpA (Ferragamo Italy), via a Dutch company. Ferragamo France distributed almost exclusively the luxury products of Ferragamo Italy in French retail stores. Ferragamo France incurred losses from 1996 through 2009, but it has been profitable since then.

The examiner compared Ferragamo France's expense ratio with a panel of other independent companies and concluded that it was higher than the ratio of the comparables. The auditor assessed additional taxes, interest, and penalties for 2009 and 2010 in the amount of €825,000. Ferragamo France appealed to the Administrative Court of Paris in 2015.

The court held in 2017 (No. 1516641/1-2) that the tax administration could neither establish that the salaries of the French employees constituted a profit transfer to Italy nor determine the amount of the potential brand enhancement benefit for the Italian parent company under article 57 of the General Tax Code, the French equivalent to section 482.

In 2018 the CAA concurred in this assessment (No. 17PA02617). The CAA also highlighted that Ferragamo Italy did not invoice its subsidiaries for brand royalties and agreed to take back unsold goods from its subsidiaries at their purchase price, without depreciation and without any restriction on quantity. Ferragamo France calculated its transfer price based on a 25 percent discount on the received products under the resale price method.

In 2021 the Conseil d'Etat, the highest court in France, overturned (No. 425577) the CAA's 2018 judgment and remanded the case to the CAA to focus on the quantification of the profits transferred and the method of calculation applied by the tax authorities.

In an arm's-length situation, Ferragamo France would have either renegotiated the purchase price for the merchandise or gone out of business, the public rapporteur at the Conseil d'Etat, who is comparable to the advocate general at the Court of Justice of the European Union, had said. Following the rapporteur's reasoning, the CAA stated that Ferragamo France incurred higher costs because of the group's trademark-improving policy.

"This cannot explain why Ferragamo France was profitable in 2010 and after without changing its transfer pricing policy," said Hazan. The CAA's 2018 decision had highlighted that fact to hold for the taxpayer.

"The CAA doesn't look at its own arguments when it came to the opposite result in its first decision," Hazan noted.

"We're not seeing a functional analysis demonstrating the rendering of a brand-enhancing service as one would have expected. The public rapporteur refers to the respective OECD guidelines but deduces just from the cost Ferragamo France spent that this type of function/service was provided," said Ossard-Quintaine.

Sixteen of the 19 comparables used by the tax administration were the same as those presented by the taxpayer to justify its own transfer pricing policy, the CAA stated. Even if the difference between the comparables' expenses and Ferragamo France is less than 10 percent and thus not significant, this is irrelevant, according to the CAA. The tax administration only had to show that this difference is not arm's length and is caused by trademark enhancement services of Ferragamo France to its Italian parent that the latter did not pay for.

"We don't learn anything in the facts of the decisions on the gross margin and range. This is typical for French transfer pricing judgments," Sardou noted. "Benchmarking is key in the audit but is of minor importance in the litigation. The courts will not go into a deep economic analysis."

The taxpayer also tried to question the examiner's adjustments by arguing that the adjustments are out of the comparable range if the transactional net margin method is used. The CAA rejected this argument because the taxpayer had used the resale price method in its transfer pricing policy.

"Taxpayers must be careful in selecting the right and rejecting the wrong method(s) in their transfer pricing documentation and audit defense. The case makes clear that a change of argument will not be heard," said Ossard-Quintaine.