taxnotes® international
Volume 107, Number 12 ■ September 19, 2022

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# Tropicana's Supply Agreement Is Arm's Length, French Court Says

**by Alexander F. Peter**

The French tax authorities did not prove that Tropicana France was dependent on Frito-Lay Switzerland or that their supply agreement violated the arm's-length principle, a French court held.

In its August 25 judgment in *Tropicana Europe SA v. Ministre de l'action et des comptes publics*, the Cour Administrative d'Appel de Douai (CAA), one of eight administrative courts of appeal in France, confirmed the previous unpublished ruling (Nos. 1701945 and 1701946) of the administrative court of Amiens, which had already held for the taxpayer in 2020. The tax authorities had assessed an undisclosed additional amount of corporate and withholding tax, as well as a company value surcharge, for tax years 2010-2013 during two audits.

"Those are the years when the French tax authorities have become serious about transfer pricing," Sabine Sardou of BDO Avocats said.

Tropicana Europe SA of Belgium operated a branch in France, where it preserved and bottled drinks made with fresh fruit juice. In 2009 it concluded a new distribution contract with Frito-Lay Trading Company (Europe) GmbH (FLTCE) in Switzerland and transferred its intellectual property. The new agreement provided a 60 percent distribution guarantee of Tropicana's production capacity for a period of three years.

Tropicana Europe SA is held 99.99 percent by Seven'Up Nederland BV, which is 100 percent owned by PepsiCo Inc., located in the United States. FLTCE is 100 percent owned by Frito-Lay Company GmbH, and both companies are located in Bern. Frito-Lay Company GmbH has been controlled since 2011 by PepsiCo Limited Gibraltar.

The French tax authorities argued that FLTCE was located in a jurisdiction whose tax rate at the time was 50 percent lower than it would have been in France. As a result, they argued that the control element of the French arm's-length principle in article 57, paragraph 2 (which is connected to article 238A of the French General Tax Code), would be irrelevant and a profit transfer could be legally presumed. On appeal, they characterized the distribution agreement as an abnormal act of management because Tropicana would forgo revenue.

The CAA disagreed with those arguments and held that the statutory 13 percent tax rate applicable in Bern should not be compared with the French corporate tax rate of 33.33 percent. Instead, the CAA said that the effective tax rates should be compared and that the tax administration bore the burden of proof.

Because the tax administration failed to provide the comparison, the dependency or control element under article 57, paragraph 1, of the French General Tax Code, the equivalent to section 482, would have to be shown, the court said. Because Tropicana and FLTCE did not hold stock in each other, they were not legally dependent, the CAA stated.

"From the facts in the decision, it's not obvious that both entities are controlled by more than 50 percent by the same entity," said Marie-Laure Hublot of PwC Société d'Avocats.

"In my opinion, the Douai Court of Appeals correctly concluded that the tax administration should have demonstrated the legal dependence through the full holding chain, which they did not do," said Stéphane Gelin of CMS Francis Lefebvre.

Being part of the same group is not sufficient to deduce a de facto economic dependency, the court held. It was up to the tax administration to provide evidence for that de facto control, which it did not do, the CAA said.

"The tax administration may have had a case on both grounds. On the legal side, it is likely that a 100 percent chain exists, and on the de facto side, Tropicana Europe acts as a 'bottler' for FLTCE," Gelin said. "But apparently they did not bring it up before the court." He added that the tax authorities "may have been confident that they did not need that since they thought they had demonstrated that FLTCE benefited from a privileged tax regime" and in that case, the dependence test would not need to be met.

Under French procedural law, all tax matters at the administrative courts are largely written procedures. "There is no oral debate," Hublot said. "The representing parties can only ask to briefly make a statement in front of the judge,





which Nicolas Duino, as a representative of Tropicana, did."

"The court cannot ascertain the facts itself but is limited to the facts presented by the parties," Sardou explained.

Because the appropriateness of management choices made by a company cannot be secondguessed by the tax administration, it has to establish the facts on which it bases the argument that the distribution agreement was an abnormal act of management, said the CAA.

"This concept of abnormal management has been created by case law, and it is unusual that the tax administration has not raised it at the lower court, and probably not during the audit either," Sardou said.

However, the tax administration could not convincingly refute Tropicana's claim that the competitive fruit juice market in Europe had led to the closure of several facilities, which had forced Tropicana to restructure accordingly. To maintain that Tropicana's losses were charged to a different customer after the restructuring is not enough to cast doubt on the soundness of Tropicana's management decision, the court held.

"It shows that the tax administration had been a tad overconfident on the privileged regime argument and that a French court is willing to receive economic arguments sustaining a business restructuring," Gelin said.

The plaintiff in *Tropicana Europe SA v. Ministre de l'action et des comptes publics* (20DA01106) was represented by Nicolas Duino of PwC Société d'Avocats Paris. • •