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ASSAULT ON MULTINATIONALS: FRENCH AND AMERICAN REALLOCATION PROVISIONS

Increasing prominence of multinational enterprises has resulted in more expansive governmental control. Illustrative of this trend is legislation which enables national authorities to reallocate income among the various members of a corporate group for tax assessment purposes. Yet, it is not merely a desire to raise additional revenue that has called these taxing statutes into play.

It is necessary first to define the problem that has given rise to the broader use of reallocation provisions. Next, an analysis will be made of two of the most important of these reallocation provisions; Section 482 of the Internal Revenue Code of the United States and Article 57 of the French General Tax Code. Finally, a brief comparison of their respective applications will precede a prediction as to their future ramifications for the multinational concern.

I. The Problem

The most frequent dispute between multinational companies and governments arises over the companies' ability to move enormous sums of money between their affiliates in different countries. It has been estimated that in 1970 the liquid assets of U.S. companies and banks with international operations amounted to approximately $30 billion, an amount "which flows in giant waves from one country to another."[1] This phenomenon can be influenced by governments, acting alone and in concert, but is beyond their power to control. The movement of funds within the multinational groups, when several follow the same policy, can threaten and sometimes destroy national currency exchange rates, balance of payments, and the availability of credit.[2]

The multinational companies have not set out to challenge governments, nor is there anything sinister about the manner in which the funds are transferred. However, the desire to suffer the least tax liability and to conduct the normal business operations of providing funds for new investment through repatriation of profits runs counter to national interests.

Each government safeguards its own interests by not only ensuring that it secures a fair share of tax from multinational operations but also ensuring that those operations are consistent with the host country's broad economic objectives. Multinational companies on the other hand recognize the favorable tax consequences which arise when income is declared in countries with the lowest tax rates and realize that tax savings can be achieved by money transfers among subsidiaries in the multinational group.[3]

Of course, undesirable monetary transfers have not been simple for governmental authorities to discover. Many diverse methods have been employed to shift income, deductions, and credits between related corporations: use of

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1 Wall Street Journal, Feb. 17, 1970, at 7, col. 6.
2 C. TUGENHAT, THE MULTINATIONALS 161 (1973) [hereinafter cited as TUGENHAT].
3 *Id.* at 164.

dividends,[4] royalties and interest payments,[5] use of loans and other capital transfers,[6] payment for goods, services and know-how,[7] or manipulation of intercompany transfer prices.[8] Yet, as more of these potentially harmful practices are uncovered, more sophisticated responses have come from concerned national authorities. Governments have answered by utilizing broadly based reallocation provisions. These provisions not only ensure a fair taxation of income realized by individual corporations within a related multinational group but also ensure that national economic objectives are followed.[9] To give an indication of the expansive interpretation now accorded to these provisions, two of the more frequently employed enactments—Section 482 of the Internal Revenue Code and Article 57 of the French General Tax Code—will be examined and compared.

II. Section 482

Section 482 of the Internal Revenue Code reads:

> In the case of two or more organizations,[10] trades or businesses[11] (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled[12] directly or in-

4 Dividend payments have been especially useful in getting money out of countries with impending economic crises. For example, in 1964 and 1965, when devaluations of the pound seemed imminent, 30% of 115 surveyed foreign-owned subsidiaries in Britain which had not paid dividends during the previous three or four years did so. Twenty-five of the 115 remitted over 100% of their earnings. M. BROOKE AND H. L. REMMERS, THE STRATEGY OF MULTINATIONAL ENTERPRISE (1970).

5 As a substitute for dividend payments, royalties and interest charges are especially useful. The object of dividend-avoiding procedures is to transfer the resources of the subsidiary company to the parent in such a form that it does not attract the taxation of the host country; *i.e.*, that it is not considered a distribution of profit. This can be achieved in one of two main ways. Resources can be transferred in forms which the taxation authorities recognize as costs against operating revenues before a trading profit is established. Alternatively, the resources can be transferred on an allocation of total income which is not subject to corporation taxation such as interest on loan capital. In either case, tax evasion is effected where only sham transactions are employed. *See* W. MANSER, THE FINANCIAL ROLE OF MULTINATIONAL ENTERPRISES 92-94 (1973).

6 This method is especially useful when interest free or rent-free loans (or interest and rentals below what would be charged to an unrelated corporation) are employed.

7 For example, by providing personal service or technical assistance without charge or with a charge other than fair market value.

8 The manipulation of transfer prices is one of the most flexible tools in the hands of a multinational company. Though it is useful to counteract the effects of exchange control regulations, restrictions on the export of capital or the repatriation of earnings, royalties and interest payments, the most common reason for manipulating transfer prices is for tax planning. This can mean anything from systematic avoidance to ensuring that the same profits are not taxed twice over by two governments, or to taking advantage of an anomaly in the international system. *See* TUGENHAT, *supra* note 2, 169-173.

9 Basically, the fear of reallocation of income brings with it the fear of double taxation. Most companies for this reason and other business considerations will decide to respect national policies of monetary control and to forego the limited advantages of short-term tax avoidance. *See* TUGENHAT, *supra* note 2, at 175-176.

10 The term "organization" refers to an organization of any kind, whether it be a sole proprietorship, partnership, trust, corporation, etc., *irrespective of the place where organized*, where operated, or where its trade or business is conducted, and regardless of whether domestic or foreign. Treas. Reg. § 1.482-1(a)(1) (1968) (emphasis added).

11 The term "trade" or "business" includes any trade or business activity of any kind, regardless of whether or where organized, whether owned individually or otherwise, and regardless of the place where carried on. Treas. Reg. § 1.482-1(a)(2) (1968).

12 The term "controlled" includes any kind of control, direct or indirect, whether legally enforceable, and however exercisable or exercised. It is the *reality* of the control which is decisive not its form or the mode of its exercise. A presumption of control arises if income or

> directly by the same interests, the Secretary or his delegate may distribute, apportion or allocate gross income, deductions, credits or allowances between or among such organizations, trades or businesses, if he determines that such distribution, apportionment or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any such organization, trade, or business.[13]

Understandably, the allocation of deductions and income is very important in the international area.[14] Under U.S. tax law, income earned by a foreign subsidiary of a U.S. corporation is generally not taxed until it is returned to the parent corporation. Thus, a U.S. parent corporation has an incentive to sell to its foreign subsidiary at a low price if the foreign subsidiary is not subject to heavy foreign taxation; the subsidiary's income upon resale to foreign customers will be correspondingly greater, but the parent will not have to report this income until it is "repatriated" to the parent in the form of dividends.[15] Also, if the subsidiary operates in a country with tax rates substantially lower than the U.S., an overall tax savings will result where no dividends to the U.S. parent are declared. If income can be shifted to a foreign subsidiary or if deductions which reflect expenses of the foreign subsidiary can be claimed by the U.S. corporation, the U.S. tax liability can again be lowered.

The purpose of § 482 as a prime weapon against tax evasion[16] has been to place a controlled taxpayer on a parity with an uncontrolled taxpayer by determining, according to the standard of an uncontrolled taxpayer, the true taxable income from the property and business of a controlled taxpayer. The interests controlling a group of controlled taxpayers are assumed to have complete power to cause each controlled taxpayer to conduct its affairs and to compile its records in such manner as to truly reflect taxable income. If this has not been done, the district director will intervene and by making any adjustments he deems necessary[17] between or among controlled taxpayers constituting the group, shall

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deductions have been arbitrarily shifted. Treas. Reg. § 1.482-1(a)(3) (1968). Thus, two corporations, each owning 50% of a shopping center, had the requisite control for § 482 purposes, even though they operated competing department stores. Forman Co., Inc. v. Comm'r., 453 F.2d 1144 (2d Cir. 1972).

13 The term "true taxable income" means in the case of a controlled taxpayer, the taxable income which would have resulted to the controlled taxpayer had it in the conduct of its affairs dealt with the other member or members of its related group at arm's length. Treas. Reg. § 1.482-1(a)(6) (1968). *See* Huber Homes, Inc. v. Comm'r., 55 T.C. 598 (1971).

14 With regard to domestic corporations, the advantage of shifting income and deductions among related corporations or businesses usually results from different rates of taxation applied. For example, if individual A owns a corporation and can split off part of the income into a partnership or a proprietorship taxed at a lower rate, then his tax liability will be lower. In the case of corporations, a surtax exemption allows the first $25,000 of income to be taxed at 22 percent rather than 48 percent. Prior to the Tax Reform Act of 1969, an affiliated group of corporations could claim a surtax exemption for each affiliate (and pay a small penalty tax). This provision is currently being phased out, but the use of multiple surtax exemptions has existed since the 1950's and § 482 has played an important role in preventing abuse in this area.

15 B. Bittker & L. Stone, Federal Income, Estate and Gift Taxation 424 (1972).

16 Section 482 is not the commissioner's only weapon against income splitting between corporate taxpayers. For example, cases like Lucas v. Earl, 281 U.S. 111 (1930) (assignment of income) as well as the Helvering v. Clifford, 309 U.S. 331 (1940) and Helvering v. Horst, 311 U.S. 112 (1940) cases have also proved to have great vitality in the field. Likewise the government may invoke § 269 to disallow deductions, credits, etc., in certain controlled corporation transactions if the principal purpose is tax avoidance.

17 The director may make any distribution, apportionments, or allocations as he may deem

determine the true taxable income of each controlled taxpayer.[18] The basic test, though not the sole one, used to determine whether deductions and income are allocated properly is whether the taxpayers dealt at arm's length—whether the transaction which occurred between the related parties would have occurred between unrelated parties as well.

Section 482 and its regulations apply to any controlled taxpayer, whether such taxpayer makes a separate or a consolidated return.[19] However, § 482 grants no right to a controlled taxpayer to apply its provisions at will, nor does it grant any right to compel the district director to apply such provisions.[20]

A. *General Application*

Current Regulations under § 482 state that transactions between one controlled taxpayer and another will be subjected to special scrutiny to ascertain whether the common control is used to reduce, avoid, or escape taxes. The authority to determine true taxable income extends to any case in which either by inadvertence or design the taxable income in whole or in part of a controlled taxpayer is other than it would have been had the taxpayer been an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer.[21] However, special scrutiny is applied to those traditional methods used to shift income and deductions between related corporations: (1) Loans or advances, (2) performances of service, (3) use of tangible property, (4) transfer or use of intangible property, and (5) sales of tangible property.

Interest-free loans from U.S. parent companies to foreign subsidiaries has been a long-standing practice. The Service first attacked this practice by imputing an interest charge from the foreign company to the U.S. parent company. The Regulations under § 482 now provide that where one member of a group of controlled entities makes a loan or advance directly or indirectly to another member of such group and charges either no interest or interest not equal to an arm's length rate, the Service may make appropriate allocations to reflect an arm's length interest rate.[22] For purposes of computation, the arm's length

necessary of gross income, deductions, credits or allowances; or of any item or element affecting taxable income, between or among the controlled taxpayers constituting the group. Treas. Reg. § 1.482-1(b)(1) (1968).

18 *Id.*

19 By filing consolidated returns as authorized by INT. REV. CODE OF 1954 §§ 1501-1505 the corporate group will be taxed only on the profits represented by its transactions with the outside world. For example, assume Corporation A owns both B and C, that B manufactures widgets and sells them at current wholesale prices to C, which sells them to the public. Assume that B and C both distribute part of their profits to A in the form of dividends. In any given year, B may be operating at a profit while C is operating at a loss. By filing a consolidated return, in effect C's loss is offset against B's gain and the dividends paid to A by B and C are disregarded. With the virtual elimination of the advantages of multiple surtax exemptions this year, many corporate groups may be expected to turn to consolidated returns and the broad applicability of § 482 in this area will be of undeniable importance.

20 Treas. Reg. § 1.482-1(b)(2)(3) (1968).

21 Treas. Reg. § 1.482-1(c) (1968).

22 Treas. Reg. § 1.482-2(a)(1) (1968). See also Treas. Reg. § 1.482-1(d)(4) which provides that "if one member of a group lends money to a second member of a group in a taxable year, the district director may make an appropriate allocation to reflect an arm's length charge for interest during such taxable year even if the second member does not realize income during such year. The provisions of this subparagraph apply even if the gross income contemplated from a series of transactions is never, in fact, realized by the other members." *Id.*

interest rate is the rate of interest that would have been charged at the time the indebtedness arose in independent transactions with or between unrelated parties under similar circumstances.[23]

The Regulations also provide that where one member of a group of controlled entities performs marketing, managerial, administrative, technical, or other services for the benefit of another member of the group without charge or at a charge not equal to an arm's length charge,[24] the Service may allocate to reflect an arm's length charge for such services.[25] Accordingly, allocations may be made to reflect charges for services undertaken for the joint benefit of the members of a controlled group and for services performed by one member of the group exclusively for the benefit of another member. In general, allocations may be made if the service, at the time it was performed, related to the carrying on of an activity by another member or was intended to benefit another member, either in the member's overall operations or in its day-to-day activities.[26]

However, these allocations will not be required if the probable benefits to the foreign affiliates are so indirect or remote as to be negligible. In addition, allocations will not be required if the services are performed by one affiliate, *e.g.*, the parent company, for its own benefit, or if the service rendered merely duplicates services which the affiliate concerned has itself performed.[27] The Regulations require that if the services rendered are not part of the trade or business of the parent company, only costs (deductions) must be charged out.[28]

Where possession, use, or occupancy of tangible property owned or leased by one member is transferred by lease or other arrangement to another member of the group without charge or at one not equal to an arm's length rental, the Service may reallocate income.[29] The determination of an arm's length rental depends on whether either affiliate is in the business of leasing the type of asset or property involved. If so, the arm's length criterion is actual rentals charged by either affiliate in independent leasing transactions. The more common situation, however, is where neither affiliate is in the leasing business—the most typical case being where one affiliate allows another use of capital equipment in its manufacturing operations, either rent-free or at a bargain rental. An arm's length rental charge would be the rental charged for the use of the same or similar property, during the time it was in use, in independent transactions between unrelated parties under similar circumstances considering the period and location of the use, the owner's investment in the property or rent paid for the property, expenses

23 Specific computation for applicable interest rates is provided by Treas. Reg. § 1.482-2(a)(2) (1968). Read literally, the regulations require that where there are loan transactions with a number of members of a controlled group the arm's length standard is to be applied to each transaction on a separate basis rather than on an overall group basis.

24 For an application here of analogous criteria to Treas. Reg. § 1.482-2(a)(2) in regard to arm's length charge, see Treas. Reg. § 1.482-2(b)(3), (6) (1968).

25 Treas. Reg. § 1.482-2(b)(1) (1968). *See, e.g.*, Glen A. Jordan, 60 T.C. 872 (1973).

26 Treas. Reg. § 1.482-2(b)(2) (1968).

27 Treas. Reg. § 1.482-2(b)(2) (1968) contains some examples which are helpful in clarifying these principles.

28 *But see* Philipp Bros. Chemical Inc. v. Comm'r., 435 F.2d 53 (2d Cir. 1970), *aff'g* 52 T.C. 240 (1969).

29 Treas. Reg. § 1.482-2(c)(1) (1968). *See* B. A. Boyer, 58 T.C. 316 (1972).

of maintaining the property, the type of property involved, its condition, and all other relevant facts.[30]

Members of a controlled group must charge each other an arm's length price whenever intangible property or any interest therein is sold, transferred, assigned, loaned, or otherwise made available by one member. Intangible property includes patents, inventions, copyrights, trademarks, franchises, licenses and contracts, as well as methods, programs, customer lists and numerous other similar items.[31] The Service may make appropriate allocations[32] and the object is to assure that any benefit conferred prompts a corresponding charge equal to that which unrelated parties would normally expect to incur.[33]

Where a controlled group member sells tangible property to another member, the Service may appropriately allocate to reflect the price that an unrelated party would have paid, reflecting a normal profit.[34]

B. *Methods of Adjustment*

The method of allocating, apportioning, or distributing income, deductions, credits, and allowances is determined with reference to the substance of the particular transactions or arrangements which result in the avoidance of taxes or the failure to clearly reflect income.[35] This broad power is made somewhat more specific by the regulations which state that "the appropriate adjustments may take the form of an increase or decrease in gross income,[36] increase or decrease in deductions (including depreciation), increase or decrease in basis of assets, or any other adjustment which may be appropriate under the circumstances."[37]

30 Treas. Reg. § 1.482-2(c)(2) (1968). As is true of the intercompany interest situation, the regulations here furnish a specific formula by which to compute an acceptable arm's length rental. Even if neither affiliate regularly leases tangible property in an activity that would be tantamount to a trade or business, the taxpayer still retains the right to establish a rental which would constitute an arm's length charge by reference to actual facts and circumstances in lieu of the established formula.

31 Treas. Reg. § 1.482-2(d)(3) (1968).

32 Treas. Reg. § 1.482-2(d)(1) (1968). *But see R. T. French Co.,* 60 T.C. 836 (1973).

33 Treas. Reg. § 1.482-2(d)(2) (1968).

An important exception to the above allocation rules relating to intangibles covers the situation in which an affiliate acquiring an interest in intangible property acquires it by being a participant in a bona fide cost-sharing arrangement. *See* Treas. Reg. § 1.482-2(d)(4) (1968).

34 Treas. Reg. § 1.482-2(e)(1) (1968).

35 Treas. Reg. § 1.482-1(d)(1) (1968).

36 For example, in Borge v. Comm'r., 405 F.2d 673 (2d Cir. 1968), a prominent entertainer entered into an employment arrangement with his wholly owned company (which was losing money in the poultry business) for $50,000 per year. The corporation hired out his services and earned average annual profits of about $160,000 from this part of its business (before payment of his salary). The Commissioner was upheld in his reallocation under § 482 of about $325,000 of additional salary to Mr. Borge over the five-year period. *Accord,* Richard Rubin, 56 T.C. 1155 (1971).

See also Advance Machinery Exchange, Inc. v. Comm'r., 196 F.2d 1006 (2d Cir. 1952) where an analogous method was used in a reallocation of income between corporations controlled by the same individuals.

37 In Oil Base, Inc. v. Comm'r., 362 F.2d 212 (9th Cir. 1966), the parent corporation granted its wholly owned subsidiary commission and discounts twice as large as those allowed uncontrolled sales representatives. Under § 482, the commissioner was successful in his reallocation of portions of the subsidiary's sales income to the parent on the basis of what would have been the parent's arm's length arrangements with uncontrolled parties.

Likewise, in Eli Lilly & Co. v. United States, 372 F.2d 990 (Ct. Cl. 1967) the commis-

Whenever the district director makes adjustments to the income of one member of a group of controlled taxpayers, he shall make appropriate correlative adjustments to the income of any other member involved in the allocation. The correlative adjustment must actually be made if the United States income tax liability of the other members would be affected for any pending taxable year. Thus, if the district director increases the income of one member of the group, he will decrease the income of the other member if such adjustment would have an effect on the United States income tax liability of the other member for any pending taxable year.[38]

C. *Court Decisions—Genesis of § 482*

The statute and regulations as to reallocation were very simple until the 1960's.[39] In fact, § 482 was used relatively little in its early years. Under § 45, the predecessor of § 482, the Commissioner could not (1) create income where none existed,[40] (2) disallow a proper deduction,[41] (3) combine or consolidate net income of separate but related taxpayers if their businesses were conducted separately without distortion of income,[42] or (4) compel an arbitrary allocation of intercompany expenses if the taxpayer's allocation was reasonable.[43]

A number of events occurred which made § 482 more important. The Revenue Acts of 1950 and 1951 and the excess profits tax provisions imposed much higher corporate tax rates upon domestic corporations. As a result, there was fear of abuse of the surtax exemption[44] and the excess profits tax credit system through the creation of subsidiaries. Thus, in response to an increased need for control of multiple corporations, the position of courts began to evolve.

Through the early 1960's, the Service instituted a concerted enforcement effort, with § 482 as the primary weapon, to increase the taxable income of U.S. taxpayers, especially on transactions with foreign affiliates; more extensive

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sioner successfully charged the parent manufacturing company with portions of the profits received on sales to outsiders by its wholly owned subsidiary where the parent's sales to the subsidiary were at less than arm's length prices.

38 *See* Treas. Reg. § 1.482-1(d)(2) (1968).

39 J. Gravelle, A History of Section 482 of the Internal Revenue Code, The Allocation of Income, Deductions, Credits and Allowances between Related Corporations, April 9, 1974 (unpublished report of The Library of Congress, Congressional Research Service), at 5 [hereinafter cited as Gravelle].

40 Tennessee-Arkansas Gravel Company v. Comm'r., 112 F.2d 508 (6th Cir. 1940). This same view apparently prevails today in relation to § 482. For example, in Huber Homes, Inc. v. Comm'r., 55 T.C. 598 (1971) the taxpayer transferred at its actual costs newly constructed houses to its wholly owned subsidiary who in turn *rented* the houses to the public. Relying on the holding of *Tennessee-Arkansas*, the Tax Court refused to *create* income out of the transaction which in the Commissioner's opinion *would have* produced income had the taxpayer dealt with its subsidiary at arm's length.

41 General Industries Corp., 35 BTA 615 (1937).

42 Seminole Flavor Company, 4 T.C. 1215 (1945). For a similar view under § 482, see cases decided under the rationale of Comm'r. v. Chelsea Products, Inc., 197 F.2d 620 (3d Cir. 1952) where the court held that the commissioner may not combine net income of corporations which are owned by the same interests where the corporations have legitimate business reasons for the separation of their business functions.

43 Welworth Realty Co., 40 BTA 97 (1939).

44 Corporations were and are taxed under a "normal" tax and a "surtax." The first $25,000 is exempt from the surtax. Currently, the normal tax is 22 percent and the surtax 28 percent so that a corporation is taxed at a 22 percent rate on its first $25,000 and 48 percent on any remainder.

regulations to § 482 were adopted. The guidelines among other things specified a proper rate of interest for intercompany loans (between 4 and 6 percent)[45] and provided three methods of intercompany sales pricing which could serve to avoid possible reallocation of profits where such intercompany sales were employed.[46]

Even before the Tax Reform Act of 1969, the major focus of § 482 was turning to foreign operations. The treatment of income and deductions of a foreign subsidiary of a United States corporation has traditionally offered substantial tax avoidance opportunities since unrepatriated income of foreign subsidiaries is not subject to U.S. taxation. Of course, this is most advantageous when the foreign income tax rates are low.

Prior to the 1960's, § 482 was hardly used in the international field; several factors were responsible for the increased use of the provision in the 1960's. In 1961 the Internal Revenue Service set up the International Enforcement Program, a more aggressive enforcement plan. Another reason was the change in United States policy in the early 1960's toward foreign investment; prior to that time, the policy had been to encourage such investment. During the 1960's there began to be increasing concern as to possible adverse effects of foreign investment on domestic investment and growth, domestic employment and particularly on the balance of payments. In addition, it was charged that there was substantial growth in "tax haven" subsidiaries, some no more than a mailing address and a lawyer's office set up for the purpose of avoiding tax.[47]

The incoming Kennedy administration, concerned about the balance of trade deficit, proposed that the income of foreign subsidiaries be taxed when earned rather than when remitted and that § 482 be revised to make it applicable to international transactions. The tax legislation as enacted did not adopt the administration's proposals, although it did attempt to tax some income from tax haven countries. While Congress did not revise § 482, it did recommend that the Internal Revenue Service promulgate regulations governing international transactions under § 482 which could be viewed as a mandate for increased enforcement.[48] Taxes collected from foreign subsidiaries increased. The result was that "commencing approximately with the beginning of the 1960's the Service instituted a concentrated enforcement effort with § 482 as the primary weapon to increase the taxable income of United States taxpayers on transactions with foreign affiliates."[49] The increased use of this section resulted in additional compliance costs and litigation as well as increased revenues.

Not surprisingly, however, relatively little case law concerning § 482 has

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45 Treas. Reg. § 1.482-2(a)(2)(i) (1968).

46 Treas. Reg. § 1.482-2(e)(2)(3)(4) set forth the methods as: 1) Comparable uncontrolled price method; 2) resale price method; and 3) cost plus method. These three prescribed methods are not alternatives. If the first price method applies, it must be used. If the first method does not apply, then the taxpayer must test to see if the second method applies before the third method could be employed. Thus, these three methods are not alternatives from which the taxpayer can choose the method most beneficial to its particular circumstances.

47 Gravelle, *supra* note 40, at 8.

48 *Id.* at 9.

49 Hammer, *Section 482—Apportionment and Allocation Guidelines,* N.Y.U. 26TH INST. ON FED. TAX 693 (1968).

involved foreign trade.[50] This may be explained by factors such as the cost and difficulties of proof involved in litigation, the reluctance of corporations to disclose company pricing policies, the possible double tax burden that could result from litigation failure, and the usual risks and uncertainties of court contests. In any event, the prime force of § 482 has emerged in its role as silent policeman, providing a deterrent to unlawful monetary transfers without the attendant need for case-by-case adjudications.

Overall, there is some evidence as to the effectiveness of § 482 in the international area today. A study of § 482's impact, based on questionnaires submitted to 512 companies and 90 personal interviews, was prepared by the Conference Board.[51] The most important findings were:

(1) A majority of the companies surveyed (271) reported some sort of reallocation by the IRS under § 482 in the past ten years.

(2) Of the companies which did not, over half indicated that transactions with related parties were not significant in their international operations. However, of the companies which did consider transactions with related companies to be of major importance, two-thirds experienced adjustments under § 482.

(3) Out of the 220 companies whose allocation cases had been settled, only three reported that they were settled in courts.

(4) The most common type of allocation was intercompany pricing of goods. The second most common was charge for services and the third was adjustments for interest charged.

(5) 283 companies said they did not change their international operations as a result of § 482; 173 reported only minor changes. 46 reported major changes and 34 said these changes have adversely affected their ability to compete.[52] Two-thirds of these companies have foreign subsidiaries that are taxed at substantially below U.S. rates.

One obvious problem which has occurred in this area, according to the reports, is double taxation. If a § 482 adjustment is made years later, it is often difficult for the company to get a refund from the foreign country and tax treaties do not always deal with this problem.

However, the majority of criticism cited was the manner in which § 482 was administered. In spite of the extensive Treasury regulations adopted in 1968, the respondents charged that the regulations were not followed in the field, that arbitrary determinations were made, and that the compliance costs in defending or settling were high. The report recommended a more detailed statute and even more detailed regulations.

50 The following cases provide an almost exhaustive list. Frank v. International Canadian Corp., 308 F.2d 520 (9th Cir. 1962); Nat Harrison Associates, Inc., 42 T.C. 601 (1964); Oil Base, Inc., 362 F.2d 212 (9th Cir. 1966), *cert. denied,* 385 U.S. 928 (1966); Eli Lilly and Co., 372 F.2d 990 (Ct. Cls. 1967); Colombian Rope Co., 42 T.C. 800 (1964); Woodward Governor Co., 55 T.C. 56 (1970); Philipp Brothers Chemical, Inc. *aff'd* 435 F.2d 53 (2d Cir. 1970); Baldwin-Lima-Hamilton Corp., 435 F.2d 182 (7th Cir. 1970); PPG Industries Inc., 55 T.C. 928 (1970); American Terrazzo Strip Co., Inc., 56 T.C. 961 (1971); U.S. Gypsum Co., 304 F. Supp. 627 (D.C. Ill. 1969); R. T. French Co., 60 T.C. 836 (1973).

51 Gravelle, *supra* note 40, at 9-10.

52 Of the 34 companies that report competitive damage, eight are in the pharmaceuticals industry. No analysis was provided of the concentration in pharmaceuticals but reasons for extensive reallocation here might include substantial international competition or perhaps the high proportion of expenditures for research and development.

III. French General Tax Code—Article 57

Article 57 of the French General Tax Code[53] declares that:

> in computing the income tax owed by firms controlled by or controlling firms outside France, profits indirectly transferred to the latter, either by increase or reduction of purchase or sale prices, or in any other way are included in the taxpayer's reported profits. The same rule applies to firms forming part of a group or controlled by a firm which also controls firms outside France.
>
> In the absence of precise information on the basis of which the adjustments provided for in the preceding paragraph can be made, the taxable income is determined by comparison with that of similar firms normally operated.

As is true with its American counterpart, § 482 of the Internal Revenue Code, article 57 is enjoying an ever-expanding interpretation in response to the rapid development of international trade.[54] Article 57 of the Tax Code is currently being used as authority for the Tax Service to adjust and subject to court review the income reported by French firms controlled by or controlling firms outside France.[55]

At the outset, theoretical application of article 57 poses a twofold problem: The control relationship between the French company and the foreign company must be established, and then there must be shown the existence of an indirect profit transfer from the French firm to the affiliated foreign firm of the same group.

Article 57 of the General Tax Code applies to a French firm controlled by a foreign firm, a French firm controlling a foreign firm, or a French firm controlled, along with one or more foreign firms, by a single firm, group, or consortium. Article 57 does not define "control" which may be de jure or de facto.[56] A French firm is "controlled" by a foreign firm when the latter holds a majority of the outstanding shares or an absolute majority of the votes which may be cast in shareholders' meetings. The same conclusion is reached when the foreign firm, directly or by nominee,[57] holds office(s) in the French firm which carries the power of decision.

A control relationship exists when one company holds a majority of the other's shares and both are managed by the same directors or executive officers.[58]

53 Code Générale des Impots, art 57.

54 The expanding interpretation now accorded to article 57 is embodied in a memorandum of May 4, 1973, published by the General Tax Service of France. Bulletin Officiel de la Direction Générale des Impots. This memorandum, hereinafter cited as B.O.D.G.I., 4-A-2-73, is the latest administrative pronouncement on the subject forthcoming from the French Government. The information contained in that memorandum forms the crux of the material used in the discussion of article 57 in this paper.

55 Internationally, treaties for the avoidance of double taxation also contain provisions similar to those of article 57.

56 B.O.D.G.I., *supra* note 54, 4-A-2-73 at 6.

57 "Nominee" is defined to include:
—Managers, directors, officers of the controlling firm (and members of their families);
—Any other firm controlled by the controlling firm;
—Any person having an interest in the business of either firm or holding shares thereof (B.O.D.G.I., *supra* note 54, 4-A-2-73 at 6).

58 Judgment of Jan. 3, 1946, [1946] Rec. Cons. d'Et., app. No. 71-963, R.O. at 3.

Thus, article 57 is particularly likely to be applicable in parent-subsidiary situations.[59] If de jure control cannot be shown, evidence of de facto control must be adduced. The control relationship may arise from contract or from the conditions under which the intercompany relationships are established.[60]

In order to make the adjustments provided by article 57 of the Tax Code, the Service must show not only that the French firm is controlled by, or controls a foreign firm, but also that the transactions subject to adjustment constitute an indirect transfer of profits abroad outside the regular management of the business.

The French Tax Service has noted that when affiliated firms controlled by industrial or financial groups having international ramifications are involved, the transfer procedures used generally result in concentration of most of the group profits in the countries having the lowest tax rates. Under the terms of article 57, such indirect profit transfers may be effected either by increase in or reduction of sale or purchase prices or in any other way. Other ways the Service has mentioned in particular are payment of royalties which are excessive or without consideration, grant of loans without interest or at reduced interest rates, forgiveness of indebtedness (waiver of stipulated interest), payment of compensation disproportionate to the service rendered, and high contribution to the group's general or research expenses.[61]

A. *General Application*

The French Tax Service will scrutinize either de jure or de facto control and will closely examine any indirect transfer of profits abroad which are outside the regular management of the business.

1. Increased Purchase or Reduced Sale Prices

Recognizing that affiliated selling companies are natural outlets for the

59 Judgment of May 23, 1960, [1960] Rec. Cons. d'Et., app. No. 42-218; Judgment of Feb. 23, 1966, [1966] Rec. Cons. d'Et., app. No. 64-449; Judgment of April 18, 1966, [1966] Rec. Cons. d'Et., app. No. 63-621.

60 The de facto control concept is illustrated by many cases:

Thus, a control relationship has been found in the case of a French company bound by contract to a foreign company which fixed the purchase and sales prices of the former, which had to report its operations and pay large royalties merely for use of a trademark belonging to the foreign firm. (Judgment of March 23, 1953, [1953] Rec. Cons. d'Et., app. No. 75-326, R.O. at 226).

Likewise, in a Judgment of May 6, 1966, [1966] Rec. Cons. d'Et., app. No. 62-129, R.O., at 159; it was held that a French company obtaining some of its contracts through a Moroccan company to which it paid out of its total profits, including those deriving from contracts in which the Moroccan company was not involved, amounts disproportionate to the services rendered by the latter campany, must be considered as controlled by the foreign company within the meaning of article 57 of the Code.

A control relationship was also found by the Conseil d'Etat in a case in which a French firm and a foreign firm having the same name manufactured the same type of product, used the services of the same representatives and on occasion divided the orders obtained by such representatives. (Judgment of Jan. 29, 1964, [1964] Rec. Cons. d'Et., app. No. 47-515, R.O. at 20.)

In a judgment of Aug. 3, 1942, [1942] Rec. Cons. d'Et., app. No. 65-810, R.O. at 177, the Conseil d'Etat held that a French firm must be considered to be controlled by a foreign firm when, undercapitalized and able to operate in its early years due only to very substantial advances received from the latter, it contented itself with exploiting in France the foreign firm's patents and processes and the foreign firm regularly supervised its operations and audited its books. (B.O.D.G.I., *supra* note 54, 4-A-2-73 at 6-7.)

61 B.O.D.G.I., *supra* note 54, 4-A-2-73 at 7.

distribution of the group products, the French Tax Service carefully scrutinizes whether a French subsidiary's purchases from the foreign firm are made at reduced prices. If so, there would be an indirect transfer abroad of profits realized by and taxable to the French company.[62] To determine the existence of such a transfer, the Tax Service refers to the prices at which the foreign manufacturer generally sells the same products to independent companies.

Enforcement in this area is strict. For example, in a judgment of June 17, 1959,[63] the Conseil d'Etat held that the benefit conferred by a French company on its foreign subsidiary by selling its products thereto at prices appreciably lower than those charged on the French and international markets constituted a transfer of profits. Since that time, case law on the point has continued to increase.[64]

However, the Tax Service has run into difficulties in attempting to demonstrate overbilling or underbilling. The difficulties have arisen for two major reasons: (1) the specificity of the imported products which often makes it difficult to use terms of comparison or (2) the fact that the service is not authorized to investigate the foreign firm to determine whether it charges its subsidiary sale prices differing from those which it charges other customers. Only nominal relief is provided by the General Administration of Customs and Indirect Duties which can provide lists of prices at which foreign manufacturers sell certain products to independent companies.[65]

2. Payment of Excessive Royalties

French companies controlled by foreign companies often pay large royalties to the latter. Such royalties stipulated by contract are calculated to compensate for services rendered by the parent company.[66] The Service first determines whether the outlays are legitimate and then whether they are commensurate with the service actually rendered. The Tax Service has noted that amounts paid on account of these services may be high without being unlawfully excessive.[67]

French companies can and frequently do utilize one of two defenses: (1) The royalty payment made to the parent by the French subsidiary is proportionate to the amount of research and development costs borne by the group as a whole; or (2) The royalty payment made to the parent company is equal to the value of the assistance which the parent company has rendered to its subsidiary.

In the frequent case when the parent company supplies the subsidiary, the French Tax Service has vowed to insure that the subsidiary does not make a dual

62 Judgment of Jan. 29, 1964, [1964] Rec. Cons. d'Et., app. No. 47-515, R.O. at 20; Judgment of April 13, 1964, [1964] Rec. Cons. d'Et., app. No. 56-173, R.O. at 69.
63 Judgment of June 17, 1959, [1959] Rec. Cons. d'Et., app. No. 38-476, R.O. at 466.
64 Judgment of May, 23, 1960, [1960] Rec. Cons. d'Et., app. No. 42-218, Judgment of Jan. 29, 1964, [1964] Rec. Cons. d'Et., app. No. 47-515, R.O. at 20.
65 B.O.D.G.I., *supra* note 54, 4-A-2-73 at 7.
66 *Id.* at 8.
67 However, authorization granted by the Ministry of Industrial and Scientific Development or by any other technical department on the subject of the rate of the royalty or of transfer of the amount thereof abroad, are not binding on the Revenue Service. B.O.D.G.I., *supra* note 54, 4-A-2-73 at 8.

contribution to the research costs, on the one hand by paying a royalty based on its sale, and on the other hand by paying for the products bought from the foreign company at a price which already makes allowances for the group research costs. The amount of royalties must reflect whether the French company confers benefits on the foreign company, especially where the subsidiary frequently provides in toto for the cost of operating the sales network as well as the advertising and informational expenses.[68]

3. Loans by the Foreign Company on Unusual Terms

The Tax Service recognized that a French company may substantially benefit a controlled foreign corporation by making loans to it without provision for interest or at a low interest rate. Under decisions of the Conseil d'Etat concerning article 57, such transactions are presumed to constitute transfers of profits abroad.[69]

When such an indirect transfer is discovered, generally there is restored to the French company's taxable income a normal interest amount. The rate may be the average interest rate on security loans charged by the Banque de France[70] or the interest rate paid by the French firm on its own borrowings.[71]

However, the Conseil d'Etat has ruled[72] that waiver of interest does not constitute a transfer of profits within the meaning of article 57 where a foreign subsidiary which has already had the benefit of advances for which the French parent company's guarantee is required is in a difficult financial position. The Conseil d'Etat considered that the French parent company had attempted to avoid losses which would have exceeded the interest amount waivered. Failure of the foreign subsidiary would have adversely affected the parent company's credit.

4. Flat Contribution to the Operating Expenses of a Foreign Subsidiary

Industrial firms often organize joint subsidiaries abroad for design, manufacture, sales, or purchases for account of all members. The division of expenses of such subsidiaries among all of the partners raises difficult problems. Thus, the Tax Service has promulgated no mandatory rules of expense division for use in this area.

In general, however, three methods of allocation have emerged and all have been used with increasing frequency by the Service. First, the Service has recommended and the Conseil d'Etat has authorized the restoration to income of sums paid by way of flat contribution to the operating expenses of a foreign subsidiary, to the extent they exceed commissions normally due.[73] Likewise, with reference to expenses incurred for the joint account of French and foreign firms, the Con-

68 B.O.D.G.I., *supra* note 54, 4-A-2-73 at 8.
69 Judgment of July 7, 1958, [1958] Rec. Cons. d'Et., app. No. 35-977, R.O. at 188, Judgment of June 14, 1963, [1963] Rec. Cons. d'Et., app. No. 57-457, R.O. at 362; Judgment of Dec. 21, 1964, [1964] Rec. Cons. d'Et., app. No. 54-142 and 56-200.
70 Judgment of Oct. 21, 1970, [1970] Rec. Cons. d'Et., app. No. 71-071; B.O.D.G.I., *supra* note 54, 4-A-5-71.
71 Judgment of Nov. 7, 1963, [1963] Rec. Cons. d'Et., app. No. 57-183, R.O. at 428.
72 Judgment of Jan. 13, 1967, [1967] Rec. Cons. d'Et., app. No. 68-139.
73 Judgment of April 18, 1966, [1966] Rec. Cons. d'Et., app. No. 63-621.

seil d'Etat has agreed in principle to a flat division.[74] The least controversial method consists of dividing joint expenses into the ratio between the sales of the French firm and the total sales of the group.[75]

In addition, two other allocation methods have been employed: (1) the ratio of the French firm's gross proceeds to the gross profit of the entire group and (2) the ratio of the French firm's assets to those of the group. Yet, no matter which method is adopted, it must always be ascertained that the division formula is based on comparable elements.[76]

B. *Methods of Adjustment*

Under article 57 of the French General Tax Code, the amount of taxable income is determined either directly by restoration to the reported income of profits wrongfully transferred out of France or by comparison with the taxable income of similar, normally operated firms.[77]

1. Direct Assessment Method

The adjustments provided for in article 57 must be made on the specific elements of the transaction which resulted in the indirect monetary transfer. Assessment by comparison is permitted only alternatively and in the absence of precise information.[78] Thus, the direct assessment procedure will be generally applied in case of waiver or absence of interest, compensation without consideration, excessive royalties, or price reduction.

2. Alternative Assessment Method

Article 57 provides that in the absence of specific information permitting determination of the taxable income of the French firm, recourse may be made to an arbitrary assessment based on comparison with the earnings of independent firms engaged in the same business. It had been held, for example, that the taxable income was validly determined by application to sales of a profit coefficient fixed by comparison with that of similar, normally operated firms.[79] The amounts restored by the Service to taxable income must be treated as distributed revenues on the basis of applicable Tax Code provisions.[80]

C. *Administrative Procedures*

It appears from the decisions of the Conseil d'Etat that article 57 of the General Tax Code can be applied only if it is established that special benefits

74 Judgment of May 8, 1964, [1964] Rec. Cons. d'Et., app. Nos. 66-968 and 68-362.
75 Judgment of April 25, 1960, [1960] Rec. Cons. d'Et., app. No. 45-099, R. O. at 60.
76 B.O.D.G.I., *supra* note 54, 4-A-2-73 at 9.
77 B.O.D.G.I., *supra* note 54, 4-A-2-73 at 11.
78 Judgment of Nov. 23, 1960, [1960] Rec. Cons. d'Et., app. No. 48-570.
79 Judgment of March 23, 1953, [1953] Rec. Cons. d'Et., app. No. 75-326, R.O. at 266.
80 If the referenced fiscal year was a profit year, then art. 109-1-1° of the General Tax Code applies. If such a year was a loss year and the foreign company receiving the proceeds indirectly transferred is a partner or shareholder of the French company then Art. 109-1-2° and 111 are to be applied. Finally, art. 111(c) covers the hidden benefits if either of the two preceding provisions cannot be applied. (B.O.D.G.I., *supra* note 54, A-2-73 at 12.)

have been conferred on the foreign company. The Service has the burden of proving the existence of such benefits and the amount thereof.[81] However, the French company is entitled to introduce evidence to the contrary and show that the apparently irregular transaction is in fact justified by operational necessities.[82]

1. Special Benefits Conferred on the Foreign Firm

The existence of special benefits raises a presumption of transfer of profits. There is no particular method of proof and the burden is on the Service to prove, by ordinary procedures, the irregular nature of the transaction which it wishes to adjust.[83]

When the taxpayer does not agree to the adjustments proposed by the Service, the disagreement may be submitted to the Departmental Commission of Direct and Turnover Taxes, which has jurisdiction to determine all questions of fact relating to the existence and amount of profits transferred abroad.[84]

If the commission approves the adjustment, the burden is on the taxpayer to prove the nonexistence of the benefits or the excessiveness of the Service's assessment.[85] If the administrative court finds that it lacks information, it may order an expert appraisement for the purpose of establishing that the French company has not conferred benefits on its foreign subsidiary or that such benefits did not constitute a transfer of profits in favor of such subsidiary.[86]

2. Presumption of Transfer

As stated above, when the existence of benefits conferred by the French firm on the foreign firm is established, article 57 creates a rebuttable presumption of transfer of profits abroad.

The Tax Service recognizes a French firm's right to adduce evidence that the benefits arising from transactions with a foreign firm answer to actual commercial necessities and not to a design to transfer profits. For example, as to certain aspects of the export trade, article 57 should not systematically be applied when the French firm establishes that transfers to its foreign subsidiary at a sale price approximating the manufacturing costs are motivated by commercial advantage and not by an intention to transfer profits.[87]

Generally, the Tax Service considers the entirety of the commercial transactions including those effected by such subsidiary. Thus, when the French company reduces its manufacturing profit in order to allow its subsidiary a merchandising margin adequate to meet competitive necessities while providing it with

81 As noted earlier, the Service must first have adduced evidence of the control relationship between the foreign company and the French company.
82 B.O.D.G.I., *supra* note 54, 4-A-2-73 at 9, 10.
83 *Id.* at 8.
84 Judgment of Jan. 29, 1964, [1964] Rec. Cons. d'Et., app. No. 47-515, R.O. at 20.
85 Judgment of Jan. 29, 1964, [1964] Rec. Cons. d'Et., app. No. 47-515, R.O. at 20; Judgment of April 13, 1964, [1964] Rec. Cons. d'Et., app. No. 56-173, R.O. at 69; Judgment of May 6, 1966, [1966] Rec. Cons. d'Et., app. No. 62-129; R.O. at 159; Judgment of June 19, 1970, [1970], Rec. Cons. d'Et., app. No. 76-270; B.O.D.G.I. 4-A-5-70.
86 Judgment of April 13, 1964, [1964] Rec. Cons. d'Et., app. No. 56-173, R.O. at 69.
87 B.O.D.G.I., *supra* note 54, 1959-II-893. An elaboration of this memorandum is provided in another memorandum of May 18, 1972 (B.O.D.G.I., *supra* note 54, 4-A-6-72).

essential operating facilities, the Service gathers all information to determine whether the transfer price approximating the manufacturing cost in France is actually required by commercial necessities.

Case law has approved the legitimacy of: (1) financial assistance to a subsidiary experiencing difficulties when the expansion of the French firm abroad might be otherwise adversely affected,[88] and (2) royalties paid to a foreign parent company at a nonexcessive rate for the use of trademarks which had not formed part of the contributions of the foreign company upon organization of the French subsidiary.[89]

Thus, the application of article 57 of the General Tax Code relates to a certain extent to the broader concept of irregular acts of management and the indirect transfer of any special benefits under whatever guise possible. While a firm may adduce countervailing evidence in the cases of financial assistance, payment of royalties, and other cases, it is much more difficult to justify such payments in the context of article 57 of the General Tax Code, since the taxpayer must rebut a presumption created by law.[90]

D. *Summary*

Recent case law and pronouncements of the General Tax Service indicate a growing importance for article 57 in French law. Though guidelines are still developing, the expansiveness of article 57's interpretations cannot be denied. Without a doubt, article 57 will require increasing diligence for multinational concerns which are controlled by or who control interests in France.

IV. Comparison

Both § 482 of the United States Internal Revenue Code and article 57 of the French General Tax Code are aimed at controlling those national enterprises which form a part of multinational corporations falling within their respective national jurisdictions. The reasons are twofold: (1) to create a parity between related and unrelated taxpayers, and (2) to afford a measure of control over undesired monetary transfers among subsidiaries in the multinational group. Governmental control is understandable considering the vast amounts of money moving within a multinational empire and the possible tax evasion or general economic disruption that may result.

Both § 482 and article 57 were originally enacted to deter tax evasion by related taxpayers organized and doing business within the same country. But, with the rapid growth of multinational trade in the last several years, their extension to the international scene has certainly been logical.

Interestingly enough, the conditions required for the operation of the two

88 Judgment of Dec. 11, 1970, [1970], Rec. Cons. d'Et., app. No. 78-698.
89 Judgment of June 19, 1970, [1970], Rec. Cons. d'Et., app. No. 76-270; B.O.D.G.I., *supra* note 54, 4-A-5-70.
90 Judgment of July 7, 1958, [1958] Rec. Cons. d'Et., app. No. 35-977, R.O. at 188. For example, in that judgment the evidence adduced was rejected as to loans without interest made to a foreign subsidiary—a transaction to which article 57 applied—while such evidence was admitted as to loans made to other subsidiaries located in France along with the parent company.

provisions—related control and prohibited monetary transfer—are identical in theory. Yet, despite the theoretical similarity between § 482 and article 57, the provisions are not without their differences. Moreover, these dissimilarities relate not only to the terminology employed but also to the application and administration of the enactments as well.

A. *Terminology*

Unlike article 57, § 482 applies to any group of related taxpayers, even though members of such a group are individual as opposed to corporate taxpayers.[91] In this respect, § 482 must be viewed as having broader application than article 57.

Section 482 applies to related taxpayers that are owned or controlled directly or indirectly by the same interests. The Regulations provide that such a requisite "control" relation will include any kind of control, direct or indirect, whether legally enforceable and however exercised.

Article 57, on the other hand, is more explicit on the question of control. The interpretation of the General Tax Service limits article 57 to either de jure or de facto control relationships. While these two concepts do give rather wide latitude to the application of article 57's provisions, they fall short of the unfettered "control" standard outlined in § 482.

Section 482 proves to be broader in yet another area. Section 482, by its terms, operates not only on direct or indirect transfers of "income" between or among related taxpayers but also on the transfer of deductions, credits, or allowances. More restrictively, operation of article 57 hinges only on profits directly or indirectly transferred among related firms—profits which should have been declared by a French company and which ultimately come to rest outside France. Whether this difference is of any consequence in the everyday practice of multinational firms remains positively unanswerable. In the case of either § 482 or article 57, the deterrent forces of possible double taxation and the high cost of litigation prohibit many transfers which might not otherwise be covered by the exact terms of the two acts.

B. *Application*

It is interesting to note the similarity between the areas of special scrutiny under § 482 and article 57. Under § 482, the IRS pays close attention to monetary transfers between related organizations which have traditionally been utilized as vehicles for tax evasion. These areas were defined to be loans or advances, performance of services for another, use of tangible property, transfer or use of intangible property, and sales of tangible property. Correspondingly, the French Tax Service has vowed to give close attention to: increased purchase or reduced sale prices, payment of excessive royalties, loans by the foreign company on unusual terms, and flat contributions to the operating expenses of foreign subsidiaries.

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91 *See, e.g.,* Borge v. Commissioner, 405 F.2d 673 (2d Cir. 1968).

Though § 482 has reached prominence as a vehicle for the reallocation of income between enterprises in the international sphere only within the last fifteen years, an important body of domestic case law in the area of income reallocation gave added meaning to § 482's application in the international sector. Article 57, on the other hand, has only paralleled the growth of international trade during the last decade and its development as a governmental enforcement tool is necessarily less pronounced. In any event, it is safe to predict that article 57 will enjoy an ever-broadening interpretation and that its use as a deterrent to undesired monetary transfers will soon require the same sophisticated scrutiny that is now applied to transactions between related taxpayers under the guise of § 482.

The methods of applying § 482 and article 57 are also somewhat different. According to the Treasury Regulations under § 482, the Commissioner is empowered to increase or decrease gross income, deductions, credits, depreciation, or the basis of any assets or to make *any other adjustment he deems appropriate* to clearly reflect the income of the related parties. Sole discretion in the determination of true taxable income is left to the IRS commissioner who is guided only in theory by the arm's length test.

Pursuant to article 57 of the General Tax Code, however, the power of the French Tax Service is more limited. Lacking discretion in the reallocation of profits, the Tax Service is provided with only two methods to redistribute profits wrongfully transferred abroad—the direct assessment method or the alternative assessment method.

C. *Administration*

Under article 57, a legal presumption of transfers of profit will arise once benefits conferred by the French firm on the foreign firm are established. However, the French firm, in all cases, may rebut the presumption by showing either that the benefits did not constitute a transfer of profits abroad or that the transfer was motivated by a commercial advantage and not a desire to prejudice the French Treasury. The burden of showing a prohibited transfer of profits rests ultimately with the Tax Service.

Pursuant to § 482, the IRS is charged with finding and collecting any discrepancy that may exist in true taxable income that has been declared or not declared by taxpayers within a related group. Unlike the administration of article 57, the ultimate presumption under § 482 must fairly be said to reside with the commissioner.

This last point is especially important in demonstrating the contrast between the positions of a multinational firm liable to income tax in France and/or liable to tax in the United States. Under the French Code, there is a basic principle of tax law that strictly interprets the tax statutes in favor of the taxpayer. According to this principle, the benefit of the doubt goes to the taxpayer who will not be taxed unless the law explicitly provides for it.[92] The United States position, while approximating the position of France *in theory*, is considerably less favorable to the multinational concern. Vested with very broad powers

92 R. David, French Law, Its Structure, Sources and Methodology, 136 (1972).

and the ability to reallocate income deductions, credits, and allowances in any transactions between related taxpayers which he deems appropriate, the U.S. Commissioner of Internal Revenue has an almost unchallengeable position under current practice.

V. Conclusion

The increasing prominence of multinational enterprises has been paralleled by an increasing desire for more governmental control over them. This control, desired for reasons of tax equity and general economic tranquility, has been forthcoming in several countries through the use of broadly based reallocation provisions. The trend is toward even greater use of these laws.

Section 482 of the IRC may perhaps be regarded as the grandfather of these statutes.[93] Developing slowly through the domestic sphere and then in the international sector, its grant of extensive power to the Internal Revenue Service cannot be denied. Though application and administration of § 482 is not without its faults, the criticisms volleyed against § 482 do little if anything to abate its strength.

Article 57 of the General Tax Code is only now emerging as the French government's prime weapon against the allocation of taxable income to related firms outside France. Case law and pronouncements of the French Tax Service show it to be less potent than § 482. Yet, as the French Tax Service has declared, the expansion of international operations now raises the possibility of hidden profit transfers by smaller and smaller firms. The response of the General Tax Service has been an avowal to give increasingly closer attention to transactions between all affiliated companies in order to detect monetary transfers of every kind.

Of course, § 482 and article 57 are not the only weapons that are useful in the reallocation of income or profits by these national governments. Treaty provisions for the avoidance of double taxation do not greatly differ from those of the two acts. Accordingly, these treaties are often construed in pari materia.

The potential ramifications for the multinational concern can be dramatic indeed. And since § 482 and article 57 are so similar, it is fairly safe to predict that application of article 57 will become even more aggressive as multinational firms establish more and more subsidiaries in France during the years ahead. A multinational operation involved with these and similar laws must pay constantly greater attention to all intercompany transactions and must endeavor not to offend these provisions. For the multinational, the cost of compliance may prove high. Yet, the cost of noncompliance will almost certainly be higher.

David P. Quint

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93 For a list of countries with similar provisions, *see* Note, *The Swiss Base Company: Tax Avoidance Device for Multinationals,* 50 NOTRE DAME LAWYER 645, 649 n. 43.