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Topic 2

CRITICAL TAX CONTROL ISSUES

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SUMMARY

Tax control ensures tax compliance. Its role is vital in combating tax fraud that jeopardizes public finances and impairs the social contract.

Recent advancements in the economic, social and technological fields constitute numerous new opportunities for fraudsters. Internationalization of business, increasing mobility of economic actors and capital, virtualization of transactions, -mainly in the banking sector-, and the emergence and role of the Internet are new challenges that the Administrations shall address appropriately.

The French Administration, as well as its partners, is faced with such issues. Three relevant topics seek to illustrate the difficulties and challenges ahead:

- The role of tax havens in tax evasion that leads to concealment of wealth and income for individuals as well as corporations;

- Relocations by multinationals who, with the excuse of a legal reorganization, transfer their benefits to low taxation areas and resort to taxation for an economic leverage effect, since the tax is a cost they seek to reduce;

- The informal economy, which calls for a uniform approach by all the State agencies, in which the Tax Administration plays a key role.

If the French Administration participates in such affairs with its control and investigation tools and anti-abuse mechanisms, the balance reached shows the need to constantly adapt the means employed and a global approach towards these challenges.

The schemes based on the use of tax havens are not new to the Administration. Multiple initiatives have been implemented in such respect, internationally, in the field of harmful tax practices as well as the European Community, by the adoption of a Code of Conduct on harmful tax competition and the implementation of the savings directive to guarantee effective taxation of the savings' interest earned by residents of the Union. Internally, the strategy stands on two pillars: the obligation to file tax statements and the anti-abuse mechanisms.

In the light of the recent cases, we must admit that the openness and transparency policy adopted by the International Community was not completely fruitful. This assertion favors a specific approach, based on the effectively cooperative nature of a territory and an improvement of the existing tools, whether the EU Savings Directive or more stringent rules in our internal procedures.

The relocation policy, identified almost a decade ago, acquires such a magnitude worldwide that it hinders the revenue of certain States. A number of such relocations entail changes in the Charter of Incorporation, which are aimed at shifting functions and related benefits to low taxation countries. Such practices are even more difficult to counter, since they are performed under uncertain legal frameworks.

The magnitude of this phenomenon and the complexity of the issues set forth have lead the OECD to implement a working group to provide clear directives. The efforts for the harmonization of Community Law and the elimination of harmful practices should enable to eradicate them in the European Union in the future. Internally, our action is based both on a voluntary ex post tax control policy and initial prevention by ex ante transfer pricing agreements.

To conclude, the harm caused by the informal economy that contributes to criminal organizations of all kinds to the detriment of the State and citizens, justifies its priority for the State and, specifically, tax control. Our action is based on the information gathered by the exclusive internal and inter-ministry services and specific procedures, but could be further enhanced by a better coordination of the State agencies and the communication regarding the consequences of tax fraud.

Beyond these three issues, the focus on the struggle against tax fraud is based on two action courses of the Administration: facilitating tax compliance to enable better acceptance of the tax, on the one hand, and maintaining an active tax control policy to punish fraud, on the other.

Tax fraud or, in broader terms, lack of tax compliance, is not anodyne at all. It reduces the resources available to finance public policies, creates competition distortions and inequitable treatment to the detriment of honest taxpayers who feel legitimate unfairness and dissatisfaction.

Tax fraud hinders an individual's perception of a fair system and reduces the benefits of competitiveness. It affects all taxpayers and all taxes. Its expansion poses a real danger for the social and economic cohesion of our countries.

The struggle against tax fraud is a great responsibility, burdening the tax administrations. Therefore, in France, tax control is deemed to secure tax compliance.

The key issue is to define priorities to be assigned to the control services as well as identify the most relevant or critical risks to be prevented by their actions.

In a business internationalization context, the increasing mobility of economic actors and capital, virtualization of transactions, chiefly in the banking sector and trade and, in Europe, the removal of border controls and the free circulation of individuals, goods and capital, three key issues concern the French Administration in the present, among others:

- The crucial issue of tax havens. In Europe, a recent case revealed how such territories enable the diversion of very significant amounts;

- «Relocations» or « business restructuring ». This issue is not new, since this phenomenon exists since the 90s, but is currently gaining momentum;

- And the informal economy thriving in our territories, mainly owing to the use of the Internet.

These three aspects are not the only ones concerning the French Administration. Just like their partners in the European Union, it shall also face, for example, a relevant VAT-fraud arising from trade within the EU (VAT carrousel fraud, fraud with second-hand-vehicles).

We shall present the French approaches to these three big challenges and the legislative as well as organizational improvements considered for the future.

I. TAX HAVENS

A very relevant and publicized case recently illustrated the issue of tax havens and, mainly, the important shifts of wealth that were concealed, enabling to identify the difficulties of States' in detecting such fraud aided by the traditional means available.

It was verified that the residents of several States, including France, owned significant assets in Liechtenstein, via shell companies, and neither such income nor the proceeds arising from their placement were filed with the tax administrations.

Nevertheless, in addition to its magnitude, it is a classic case of equity investment by assimilated associations or structures in a tax haven that all countries are potentially faced with.

Concealment of wealth and income facilitated by accounts protected by bank secrecy combined with low, or even zero taxation for non-residents, are the normal advantages tax havens offer.

Such practices are largely facilitated by the absence of Exchange controls, internationalization of trade, modern means of communications and distance management of bank accounts and virtualization of currency and payments.

A. Problems detected

- For individuals, tax havens enable to avoid not only Income Tax, but also inheritance or personal wealth taxes.

The use in these territories of legal instruments such as trusts, foundations or national trusts, which blur the ownership of wealth, disrupt legal ownership from beneficial ownership and avoid the subjection to taxes of the assets owned and the income they produce.

To conceal income from a business activity, tax fraud may be perpetrated by the creation in such territories of a shell company, lacking substance, in charge of receiving the income corresponding to the remuneration of the services rendered by an individual or the exploitation of intellectual property or image rights thereof. Examples are companies who manage the image of high-competition athletes, which enables them to earn a concealed salary by establishing themselves in such territories.

- For corporations, we particularly verify the following situations in which they take advantage of tax havens:

- The fictitious domicile of a corporation in a tax haven while the effective management address is registered in France. In order to effectively combat this type of fraud, we must rely on material evidence that is frequently obtained only by searching the corporation;

- Direct or indirect transfers of income by the reduction of income or increase of tax burdens, even by creating undue expenses in order to duly place income in the company installed in a low taxation country. We chiefly verified the artificial increase of payments for services, fees, interest, royalties, whose status and fair price are particularly difficult to control, mainly in the case of intangible services;

- The use of a stepping stone company in a country with weak taxation level, managed and controlled by a corporation based in France. Interchanging it in the normal operations of the group enables the artificial location of a portion of the margin. For example, for purchase-resale activities, the stepping stone company may be used to buy products from the headquarters in order to sell them to affiliates of the group, capturing the benefit in the tax haven.

B. International actions

Tax havens are not a new issue. States quickly became aware that the struggle against tax evasion in this sphere required global and concerted action.

France's efforts are supported by the initiatives undertaken in 1996 jointly in the Organization for Economic Cooperation and Development (OECD) and the European Union (EU), which seek to combat harmful tax competition.

1. The efforts in the framework of the OECD: an incentives' policy for greater transparency

In 1998, the OECD published a report on harmful tax competition, which determines the existence of preferential tax regimes in some OECD-Member States[1] and practices in numerous non-OECD territories and States that would qualify them as tax havens[2].

With regards to the latter, the OECD announced the creation of a list of States and territories against which its members would be invited to enforce retaliation measures (anti-abuse mechanisms, etc.).

In the year 2000, it published a report on the progress in the identification and elimination of harmful tax practices, resulting in a list of 35 States or territories that met the criteria of tax haven[3].

The OECD sought tax havens to assume commitments in terms of transparency and information exchange. A model Information Exchange Agreement was adopted, with the consensus from OECD countries and tax havens, which addressed tax fraud as well as tax evasion.

[1] 47 harmful regimes were identified later, then dismantled by a «Forum on Harmful Tax Competition» created with the sponsorship of the OECD Fiscal Affairs Committee and chaired by France.
[2] Four criteria were agreed: almost absence of direct taxation, scarce local economic activities, opacity of the applicable and applied tax regulations, and lack of information filed to the tax administrations of other countries.
[3] Another six (Bermudas, Cayman Islands, San Marino, Mauritius, Cyprus and Malta) were not mentioned since they had already assumed a commitment in terms of transparency and information exchange (see below).

In exchange for this commitment, they were offered the adhesion to the World Forum, the exclusion from the list, exemption from the application of any coordinated framework of defensive measures, and the certainty that the non-cooperating jurisdictions would be uniformly subject to such a framework.

Certain that they would continue being attractive for their low taxation level and concerned about being included in a black list of non-cooperative countries, 32 States or territories promised to apply greater transparency. Firstly, they would remove bank secrecy vis-à-vis tax fraud, and then tax evasion, or modify their legislation so they would no longer be considered tax havens. Currently, this list comprises only three territories: Andorra, Liechtenstein and Monaco.

Since then, Australia, the Netherlands, the United Kingdom and Nordic countries subscribed a number of information exchange agreements with very few tax havens. France plans to subscribe at least two agreements.

2. Initiatives in the European Union

At the European level, a first series of efforts enabled the adoption by every Member State in 1997 of the Code of Conduct on harmful tax competition.

Then, in 2003, so that certain Union residents would no longer avoid taxation on the interest earned in another Member State, the council adopted Directive 2003/48/EC of June 3rd, 2003 on taxation of savings income in the form of interest payments.

a) The Code of Conduct.

By adopting the Code of Conduct in 1997, Member States promised to eliminate the tax measures in place that foster harmful tax competition («dismantling») and to refrain from introducing any new measure with such effect («freezing»).

This code refers to the measures that have, or may have, a sensitive incidence on the localization of economic activities in the European Union, such as those foreseeing an effective tax burden clearly lower than the general one applied in the pertinent country, tax advantages reserved to non-residents, tax incentives in favor of activities unrelated to the local economy, so they do not impact the national tax base, granting tax benefits even in the absence of any effective economic activity, rules to determine the income of corporations that form part of a multinational group that depart the generally applied international rules, mainly those approved by the OECD.

A report from November 1999 gathered 66 tax measures that present harmful elements (40 in the EU Member States, 3 in Gibraltar and 23 in the dependent or associated territories).

Member States and their dependent or associated territories currently corrected or replaced these 66 measures or are about to do so. For the entities that benefited with such regimes until December 31st of 2000, a clause on acquired rights was set forth, according to which their benefits had to be discontinued as of December 31st of 2005,

whether agreed for a given term or not. For certain measures in effect in the Member States and their dependent or associated territories, limited extensions were agreed beyond 2005.

Since then, the «Code of Conduct» group guarantees to monitor the freeze and the implementation of the dismantling effort, and regularly reports to the Council.

b) The Savings' Directive: a specific information exchange instrument on interest among financial centers outside of the EU.

Taking advantage of the free circulation of goods, certain residents of the Member States avoided any form of taxation on interest earned in another Member State, other than their State of residence, creating a distortion in the effective taxation of the income from savings.

Additionally, it fostered tax evasion on the income from savings and stressed the tax pressure on income from a less mobile source, such as the income from work, with a detrimental effect on the cost of the latter, and thus, indirectly, on employment creation.

In order to close the issue, as from July 1st, 2005 the Directive organizes a system that enables taxation in the State of residence of the interest paid by a paying agent to an individual resident in the State of the Community, called the effective beneficiary. This system foresees:

- The principle of disclosure by the Member States of the payments in the form of interest made by paying entities in favor of individuals who are effective beneficiaries residents of the Member States (information exchange) ;

- Exceptionally, applying a source withholding during a temporary period in the 3 Member States that do not participate in the information exchange effort since they apply bank secrecy (Austria, Belgium and Luxembourg). The source withholding rate, initially 15 %, is 20% from July 1st, 2008 and shall change to 35% on July 1st, 2011. The paying State withholds 25%.

The source withholding system is also applied in ten dependant or associated countries of the Member States (Anglo-Normand Isles, Isle of Man and dependant or associated countries of the Caribbean) and in five third-party countries from Europe (Monaco, Andorra, San Marino, Liechtenstein and Switzerland).

The temporary source withholding period shall conclude when:

- the Union subscribes an agreement with the five third-party States providing for the exchange of information upon request relative to the payment of interest according to the 2002 OECD Model Convention, such payments continue to enforce source withholdings simultaneously;

- The United States shall commit to exchange information upon request with regards to the interest payment, pursuant to the model convention, with all the EU Member States.

In 2006, France received 580,000 reports– all the information may be used by the agencies - and 50 Million Euros in source withholdings.

C. Internal actions

Internally, the withholding mechanism tends to obtain, in the first place - or at the spontaneous request of taxpayers or establishments-, banking and financial information that could reveal the use of tax havens.

Concurrently with these measures to facilitate detection, other internal law provisions are aimed at preventing abuses and punishing them with direct focus on the relations of French residents with such territories.

1. Access to banking and financial information

The Administration enjoys the right of disclosure enabling, on the one hand, to obtain banking information from the financial institutions, and on the other, information on the transfer of funds to foreign jurisdictions, mainly, by individuals.

Tax legislation imposes upon individuals, associations and corporations lacking commercial operations, domiciled or established in France, filing, simultaneously with their income statements, the information on the accounts held, used or closed in foreign jurisdictions. For each bank account that is not filed, a € 750 fine shall apply.

Finally, the law foresees that individuals, who transfer amounts or assets in excess of € 7,600 to foreign jurisdictions without the intervention of banks, are mandated to file them.

In case of noncompliance with these obligations, the law sets forth a presumption of concealment of income vis-à-vis the amounts paid or withdrawn from accounts that have not been filed or transferred without filing the transaction.

2. Anti-abuse mechanisms

Such mechanisms establish a tax evasion presumption vis-à-vis entities established in preferential tax regimes.

Tax legislation foresees:

- Taxation of the corporation established in France for the income of their subsidiaries or branches established in a country with a preferential tax regime. In the absence of an effective industrial and commercial activity conducted in the country with the preferential tax regime, it reverses, according to certain conditions, the burden of the proof to the detriment of the French companies, since they are mandated to justify an interest other than a tax interest in the location of their income in such territories [Art. 209 B du CGI] ;

- Taxation of the income of individuals domiciled in France who own more than 10% of the equity of corporations or entities established in a preferential tax regime [Art. 123 bis du CGI] ;

- Taxation of the service provider established or domiciled in France for the amounts received as service payments by an individual domiciled or established in a preferential tax regime. It is also applied to the service provider domiciled outside of France when the service was rendered in France. This mechanism is aimed at preventing the use of shell companies to avoid the tax normally enforced in France, mainly by performers and athletes [Art. 155 du CGI] ;

- That the amounts paid to individuals domiciled or established in a preferential tax regime are not deducted by the businesses established in France unless they provide evidence of the operations that underlie such expenses and that the prices paid are within the normal ranges. This measure is applied to interest, royalties and remuneration for goods and services and all the payments made in an account opened in such States or territories [Art. 238 A du CGI].

D. Conclusions

▪ Since the efforts are conducted under the OECD umbrella, recent elements of context confirmed that the current situation was not satisfactory and that the approach from the incentive standpoint, only based on the good will of tax havens had limited effects:

- Certain jurisdictions still refuse to subscribe transparency and information exchange agreements and thus remain on the OECD list without complaints;

- Others subscribe agreements that allow them to remain on the list, but do not subscribe information exchange agreements.

The few jurisdictions that abide by their commitments could thus be harmed by the absence of protective measures implemented jointly by the OECD Member States for other territories, in spite of the initial announcements. Additionally, this lack of response does not promote the latter's' cooperation.

▪ The Savings' Directive mechanism features weaknesses mostly tied to its scope of application. It only covers individuals and a category of financial products and does not

include certain important financial centers, mainly Asian. Additionally, it does not provide for the application by all the Member States of an exchange mechanism.

In France, the source withholdings' amount paid by third-party States and associated territories seem to be limited and not very consistent with the total income located therein. On the other hand, Member States do not rely on any means to control the amount withheld at the source paid thereto. Also, without information on the owners of capital, taxation of net worth is impossible to determine.

- Internally, beyond the anti-abuse mechanisms reviewed recently to adjust them to Community Law, gathering taxpayers' banking information is deemed ineffective (in 2006, only 25,000 accounts opened in foreign jurisdictions were filed for the 35 million tax statements), which seems incompatible with the facts set forth by the foregoing case.

Overall, the conclusions show that the current mechanisms must be improved.

E. Outlooks

1. In the international sphere, improve the existing mechanisms.

In the international sphere, France considers that it is necessary to pursue and sustain the efforts undertaken.

a) At the OECD level: privilege a differentiated approach

France supports the initiatives of the OECD Committee on Fiscal Affairs, which decided in the beginning of 2008 to act on two fronts:

- Develop a method to differentiate territories according to their degree of effective cooperation, in order to provide an incentive to the countries that have doubts with regards to subscribing information exchange agreements;

- Undertake a common reflection on the potential retaliation (anti-abuse mechanisms) against the territories that seem to be non-cooperative.

Additionally, a consensus exists to refuse to sign, even report, each tax convention that does not foresee a total and complete exchange of tax data according to the new Article 26 of the OECD Model Tax Convention.

b –In the EU: improve the Savings' Directive.

France, mainly based on the fact that it chairs the EU, sustains very active efforts aimed at improving the Savings' Directive and the renegotiation thereof, mainly in order to broaden their scope to individuals and other financial products and their extension to other financial centers (such as Hong Kong and Singapore).

Essentially, the modifications required in the Directive would be aimed at:

Broadening the scope of the products covered beyond the classic interest-bearing products, such as non-interest bearing products – byproducts or life insurance– or innovative financial products;

- Better identify the effective beneficiaries of such income in order to avoid concealment aimed at using certain entities, such as trusts, between the paying bank and the final beneficiary to avoid the provisions of the Directive;

- To put an end, as soon as possible, to the temporary source withholdings' regime. Belgium, Luxembourg and Austria would be required to apply the automated exchange of information and, consequently, waive bank secrecy, at least for the non-resident Community citizens.

2. Internal approach.

Internally, we have identified margins of progress that combine, on the one hand, better taxpayers' information in order to prevent tax fraud and on the other, new action means for the Administration in order to counter the most serious actions.

b) Inform and prevent.

▪ We are studying a relevant communication campaign to make taxpayers aware of the fact that tax fraud constitutes a genuinely serious crime, which carries potentially serious sanctions for the author. In France, it is truly a novelty.

As regards tax havens, as recommended by the OECD, this communication initiative could pursue the following objectives:

- Remind the rules vis-à-vis tax territoriality;

- Make taxpayers aware of the risks posed by the jurisdictions mentioned, in absence of a regulation that protects accountholders;

- Encourage taxpayers to preserve their assets in a jurisdiction that applies the OECD standards.

▪ We have also foreseen clarifying the legislation relative to trusts or assimilated entities, structures frequently employed in connection with tax havens but not foreseen by French Law, to establish the net worth taxes based on the French notion of legal ownership (rights to transfers for no valuable consideration and personal assets) adopting a specific and secure legal entity. This clarification would enable to overcome ambiguous construal.

▪ Since the issue is compiling banking information from taxpayers, in addition to being better informed, which is undoubtedly necessary, we are considering a more deterrent penalty amount in case of noncompliance with this obligation. It may vary according to the place where the account has been is opened.

c) Stricter tax control procedures vis-à-vis Anti-tax fraud efforts.

We have foreseen two measures:

- Duplication of review terms (6 years) when the taxpayer failed to file the accounts opened in a tax haven or the income or profit from entities based in a tax haven, owned thereby. Limiting the «right to not file» of taxpayers resorting to the advantages of tax havens would enable the Administration to rectify their situation for a longer period. This would also contribute to prevent this type of behaviors;

- The creation of a judicial tax investigation service that set forth prerogatives that traditionally corresponded to the Marshall Service's officers (police surveillance, background checks, telephone tapping, etc.). A portion of the punitive action conducted by the Tax Administration with their administrative procedures would be shifted to the criminal sphere, that is to say, headed by agents of the Administration under the judicial authority, and which rely on more powerful investigation tools. These new powers shall enable to mitigate the weaknesses of the purely administrative anti-tax haven procedures. This vast reform in France could be adopted prior to the end of the year.

II. REESTRUCTURING MULTINATIONALS

The tax strategy is at the core of the financial management of multinationals. This reality arises from the growing globalization of the economies and the prevailing position of multinationals that under the joint pressure of markets and their shareholders seek to increase their profits without limits.

For such groups, taxes are a cost they seek to reduce[4].

A. Issues identified.

Along with traditional issues relative to transfer pricing or tied to the transfers of financial or intangible assets, frequently discussed with multinationals, we increasingly witness "relocation" practices.

Effectively, such groups undertake internal reorganizations generally spurred by their participation in multiple market areas.

Thus, they justify corporate restructuring chiefly on commercial reasons, such as the wish to maximize synergies and economies of scale, optimize management of business lines and improve the efficacy of the industrial and commercial chain, taking advantage of the development of Internet-based technologies.

Contrary to industrial relocation sometimes experienced by France, as well as other countries, such relocation is marked by maintaining investments in our territories (plants, equipment, and offices) and staff.

[4] For example, a report by Landwell in 2004 « Global retail and tax benchmarking survey» points out that the impact of a 1% reduction of the effective tax rate is identical with regards to the share price obtained with a 15% sales increase.

Nevertheless, in general terms, such restructuring is marked by a redistribution of the income earned by the French entity, sometimes considerable.

Some of these relocations were performed among countries within the European Union to benefit from favorable regimes. But, after Member States adopted the Code of Conduct in 1997, which purpose is to put an end to such regimes within the Community, (see above), currently, countries with preferential tax regimes (for example, in Europe, Switzerland) benefit the most from the redistribution of the tax base. Presently, such relocation is performed by:

- The transformation of the corporations that fully perform distribution functions into distributors with limited risk or agents that conduct business on behalf of a related company;

- The transformation of manufacturers in sub-contractors or custom manufacturers that operate as agents of a related company.

Such legal transformations pursue a significant taxable income reduction and generally translate into:

- Maintaining in France almost all the exploitation means (sites, equipment, personnel, etc.) and the business activity for custom manufacturers and agents and the transfer of senior management to the headquarters;

- Headquarters rendering services for all the related companies (accounting, payroll settlement, finances, HR, legal affairs, IT, etc.).

Overall, the headquarters become the service provider with regards to the custom manufacturer and the agent. It is responsible for the strategy, the purchase of raw material, the decision to commission production, and owns the finished products, stocks, and bears the risk with regards to prices, exchange rates and noncompliance by clients.

The operating subsidiaries, according to this structure, receive remuneration for the routine functions and reduce their profitability. They are deemed sub-contractors with low value added with a guaranteed but limited remuneration.

B. Action Means.

The selection of the groups' form of corporate organization, mainly a legal decision adopted thereby, when evident, is not arguable from the tax standpoint, except when they pursue a tax purpose exclusively. According to the above, proving the legitimacy of the events, which would lead the Administration to make rectifications, is still difficult.

Consequently, our control services deeply examine the tax consequence of the restructuring schemes undertaken by such groups.

Firstly, they determine the effective nature of legal transformations. They verify that the economic risks and functions that were previously assumed by the corporation or the restructured French establishment are really transferred.

Should the restructuring correspond to the effective reorganization, the financial modalities shall be controlled. The Administration verifies that the prices applied in the framework of the new policy fit the principle of open competition after examining the functions performed, the risk incurred and the equipment and intangible assets used by each one of the companies in the group.

The extraordinary burdens tied to the restructuring (severance pay, losses from assets that lost their value…) may be dismissed when it is possible to prove they were incurred to the benefit of another entity in the group.

Should the restructuring not be effective, the agencies focus on an overall examination of the structure, considering the effective transfers among the subsidiaries, when applicable.

C. Conclusions.

Our view is twofold:

- Such restructuring efforts are increasingly numerous and the transfer of profits arising therefrom are significant. Rectifications referred to restructuring operations account for approximately one billion Euros.

- The Administration's power to take action is limited before a complex problem, with imprecise legal frameworks.

Agencies face difficulties in establishing the burden of the proof in the transfer of benefits, obtaining the information required in doing so and the uncertainty with regards to the rule of law and the case law with regards to this issue, particularly in a Civil Law country where the contract is binding for the parties.

Other than the hypothesis of altering the facts, the consequences of reorganization may be argued pursuant to the normal transfer pricing principles, in order to determine the portion of income that shall be actually allocated to the restructured entity. This approach only barely corrects the effects of such relocation.

D. Outlooks.

1. International: limiting the attractive of relocations.

In the international sphere, the relevance of the business restructuring phenomena leads the States to discuss this issue in the international fora.

a) At the OECD level: provide guidelines.

The efforts of the OECD working group on «business restructuring», in which France participates, should be concluded in 2009.

The efforts are aimed at, on the one hand, developing a clear analytical framework that guarantees sufficient legal certainty for the «legitimate» restructuring of corporations vis-à-vis agreements as well as with regards to the transfer pricing notions, and, on the other, guarantee governments the possibility of countering abusive restructuring or those lacking an economic ground.

In practice, the idea is to identify to what extent the reallocation of income arising from a restructuring, in general, fit the principle of open competition and, more broadly, in what way may the principle of open competition be applied to restructurings.

Clear guidelines should be provided for the administrations as well as businesses with regards to the type and tax treatment for this type of transactions.

b) At the EU level: combat harmful tax practices and continue with harmonization efforts.

At the European level, the work for the implementation of a common tax policy to prevent, at least, the relocations of an essential tax nature inside the EU are underway in the EU, and France participates actively therein.

Since by virtue of the Code of Conduct the Member States have promised to eliminate the tax measures that spur a harmful tax competition, to refrain from introducing more in the future (see above), the efforts by the group implemented in 1999 to identify and pursue the dismantling thereof, shall be continued.

France supports and also participates in the efforts on the Corporate Tax rate harmonization by adopting a common consolidated Corporate Tax rate to cover all the activities inside the EU of the corporations operating in several Member States (ACCIS or CCCTB, Common Consolidated Corporate Tax Base). Such efforts shall enable a more visible direct tax competency since it is based, essentially, only on the tax rates.

2. Internally: maintain the tax control pressure and prevent difficulties.

Our policy consists in maintaining a strong pressure via tax controls to verify the tax relocations and adopt a stricter approach, inspired on the work underway in the OECD.

For example, it would entail verifying that a fair severance or compensation amount has been paid when the change in contractual relations results in a visible reduction of future income (loss of business opportunity).

But our action cannot be limited to an ex post control. In line with tax control, we have developed an active risk prevention policy at the beginning of the chain. In 1999, we implemented a procedure based on a pre-agreement vis-à-vis transfer pricing, a legal

certainty instrument for corporations. By virtue of this procedure lead by an exclusive team within the Administration, it is enabled to examine such restructurings to the closest extent possible prior to their effectiveness. This procedure is an answer adapted to the difficulties identified, since it leads to dialog with corporations based on trust and transparency. It avoids the ex post policy for the Administration and enables to provide certainty for the groups in the implementation of the restructuring efforts. A total of 9 agreements were signed in 2006, 12 in 2007, and approximately 20 are expected in 2008.

III. THE INFORMAL ECONOMY

In France, concealing business activities is a form of avoiding not only the tax pressure, but also the social contributions and the administrative limitations of all kinds.

The harm caused by the informal economy – revenue and corporate tax losses that finance public policies and, mainly, social protection, false competition for qualified operators, laundering that favors criminal networks – justify that combating the informal economy be prioritized by the State, particularly, for the purpose of tax control.

The French model to combat the informal economy brings numerous actors and means to the forefront. This organization is firstly the result of an old political, economic and administrative history and the action of the State depends on our governing principles: equality, rule of law, tax equity, and assistance equity.

It is based on well-defined administrative structures, in a context of a high level of compliance, mainly with regards to taxes.

A. Issues identified

Beyond an individual's illegal or concealed activity, the non-filed activities, whether legal or illegal, assume different forms, with varying degrees of complexity:

- The use of companies who fail to file their statements, frequently short-lived intentionally and challenging the Administration's reaction capacity. This practice may be combined with the use of a cascade of sub-contractors, chiefly in the Public Works' sector;

- Conducting a relevant activity, breaking it down among a number of small corporations, enabling fraudsters to benefit from the advantages granted to the small businesses and transform important challenges into "apparently" weak challenges for the Administration and, therefore, ignored;

- A foreign corporation's permanent establishment undertaking an activity that they conceal (or fictitious relocations in a foreign jurisdiction).

We may also mention the activities, which have been filed, but whose actual volume is concealed by the reduction of the income produced by such activities. It is a simple, but broadly disseminated method.

Concealing a business activity is generally accompanied by illegal labor, that is to say, employment of employees who are not registered.

Although the informal economy may be pertinent to all activities, certain economic sectors are more involved, by virtue of their inherent features. We generally define three:

- The sectors that employ a large number of low-skilled workers, and in a high-demand period may be induced, based on the high contributions, to employ illegal workers: tourism, gastronomy, construction, agriculture, public works, cleaning services, textile industry, security services, etc. ;

- Sectors whose activity generates circulation of cash, easy to disguise owing to their nature: retailers, bars, discos, hotels, restaurants, prepaid cards, etc.;

- Sectors that generate a strong value added, in which small volumes produce great income: IT, telephony, forgery and traffic of luxury goods.

To conclude, undertaking a concealed activity is currently facilitated by the evolution of the digital technologies that facilitate virtual transactions and offer communications' tools as well as, remote management, in absolute anonymity. They grant new outlooks to the informal economy with the effective support of the Internet.

Many sites enable to perform commercial activities, chiefly sales, which go uncontrolled by the use of pseudonyms. Such technologies allow the dissemination of certain procedures such as the use of off-shore accounts with credit cards linked thereto. To conclude, the use of accounting software or uncontrolled cash registers with functionalities that enable to correct transactions enables to easily conceal a part of the activity recorded initially.

B. Action means.

Although IT currently plays an important role in the management of useful administrative information, in France the struggle against the informal economy is chiefly waged on site, as close to the actors and the economic realities as possible.

Thus, we rely on resources devoted to investigation and intelligence, implementation of extraordinary procedures and coordination of the different pertinent State agencies to detect the concealed activities.

a) Exclusive investigation agencies.

We employ control and investigation units deployed as close as possible to the activity center (more than 1000 agents), which guarantee the liaison with other Administrations.

At the national level, a National Tax Investigations' Directorate (over 400 agents) is in charge of identifying the most complex fraudulent behaviors and controlling the high risk

activities in the situations requiring a great response capacity. It cooperates with other equivalent EU agencies.

b) Extraordinary administrative procedures.

In addition to numerous mechanisms facilitating access to third-party information, the Tax Administration relies on two procedures adapted to the detection of concealed activities:

- The right to conduct on-site inspections and attach assets, an exceptional administrative procedure, prior a court authorization, in professional and private locations and attach accounting or non-accounting documentation in order to establish the alleged fraud, to subsequently face the taxpayer therewith. It is a passive search;

- The immediate tax authority to facilitate the enforcement of preventive attachments upon proving fraudulent practices of confirmed severity such as a concealed activity or employment of illegal labor. This is a means to secure collection of the taxes avoided.

c) Inter-ministry action centered on illegal labor, the common denominator in the phenomenon.

Violations related with the informal economy depend on several laws and administrations (tax, social, labor, customs, economic, etc.). Circulation of information and common efforts need to be organized among the different agencies.

Such coordination and its exchange focused on illegal labor or illegal activities shall be performed at:

- The anti-illegal labor Operating Committees, which bring together, at the level of Departments, the control bodies of the different administrations (labor, social, taxes, law enforcement, etc.) under the authority of the District Attorney. It is the key structure of the operating anti-illegal labor effort. Such committees organize the circulation of information and guarantee on site coordination of the actions. In practice, monthly meetings are organized in which participants exchange information on fraudulent activities or networks, each Administration presents the issues addressed and, subsequently, joint actions are decided and organized. Such meetings are coordinated by the administrations, either individually or collectively;

- The Immediate Intervention Groups (*Groupements d'intervention rapide, GIR,* as per the French acronym): inter-ministry operating structures created in 2002, whose mission is to counter the informal economy and the different forms of organized crime (drug trafficking, stolen objects, etc.). The GIR bring together the agents deployed to such purpose (agents from law enforcement agencies, border patrol, customs, tax authorities, fraud control, labor) who report to a police commissioner or border patrol officer.

In addition to these two mechanisms, our investigation services work more actively and bilaterally with other State agencies.

C. Conclusions.

The results of tax control efforts in terms of detection, related control and punishment, except for collection, which remains low, are high (2007: 8,300 inspections revealing income or activities concealed for a total of € 450 Million worth of evaded taxes, 800 tax fraud cases in court).

Nevertheless, such results do not allow, per se, measuring the effects of the actions of the Administration on the informal economy.

They should even call to caution, since they prove that, if sustained at high levels, the struggle against the informal economy – a tax control priority for a number of years–is not exhausted and the phenomenon prevails.

On the other hand, the general perception is broadly that the informal economy remains important and that the new related methods, mainly the Internet, enable its further expansion.

- The assessments of this parallel economy are diverging. The methods are complex and frequently weak. Recent studies estimate tax and social contributions' evasion between 30 and 40 Billion Euros from illegal labor and informal economy, which would account for 3 % of the GDP.

On the other hand, we may observe that society tolerates the informal economy and fails to perceive its severity.

Finally, this phenomenon is not appropriately addressed by the State, whose agencies still fail to integrate.

D. Outlooks.

In the face of this context, our action is aimed at improving citizens' awareness on the severity of this phenomenon, better coordinate State agencies and furnish them with the most effective tools.

a) Communicate on the consequences of tax fraud.

Just as in the case of tax havens, we are considering an important tax fraud communications' campaign to inform the population, mainly the higher-risk groups, on the effects and risks of tax fraud.

b) Continue the integration policy with State agencies that sometimes act dispersedly against the informal economy.

We have decidedly implemented a policy to integrate the administrations and improve the cross-sectional action by all the actors involved in the combat against crime.

On April 3rd of 2008, the tax and social administrations have entered into an agreement aimed at organizing, facilitating and following-up information exchange efforts. The databases of different administrations shall be crossed.

The agents from both entities shall assume reciprocal obligations in terms of fraud identification and information delivery.

Training and information programs shall be implemented to explain to each agent involved the individual area of competencies and improve the global knowledge of fraud phenomena.

This agreement reflects a strong will aimed at fostering relations among the agents involved that shall apply locally within the framework of the agreements subscribed by the agencies.

On April 18th, we also created a National Anti-Tax Fraud Delegation.

The Delegation, created by decision of the Prime Minister, under the responsibility of the Ministry of Budget, has the Mission to:

- Protect the efficacy and coordination of the anti-tax fraud actions performed by the State and Social Security agencies;

- Improve the knowledge on fraud with an impact on public finances;

- Favor the development of information exchange efforts and the interconnection of the databases of the different administrations involved in tax fraud issues.

c) Improve the Administration's capacity to detect the concealed operators.

Two measures:

- Obtain the information on the anonymous Internet users for commercial purposes. In order to identify and locate the users of the e-commerce sites, including free ones financed with advertising, the Administration shall access the data identifying them kept by the Internet Service Providers, by hosting companies and e-commerce service providers.

- Evidently, the tax police mentioned in the framework of tax havens could offer new tools to detect and mislead the operators of the informal economy.

IV. Conclusions

Beyond these three critical issues and the answers triggered by each one, our approach to increase tax compliance in France is based on a permanent balance among our two action axes:

- Ongoing improvement in the quality of taxpayers' services, chiefly, by simplifying the formalities required, improving our organization, making it user-centered to favor their access, broad guarantees based on relations of trust, as well as a strong legal certainty. Overall, the Administration should facilitate taxation;

- And a structured tax control, with an ongoing intensity, present in a balanced fashion in all the sectors and across the territory, focused on their budgetary, deterrence and punitive purposes. In fact, we work on the basis of the principle that in the current context, favorable to tax fraud, the progress made to facilitate taxation does not justify a reduction of tax controls.