

AN ALERT FROM THE BDO INTERNATIONAL TAX PRACTICE

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► **SUBJECT**

FRENCH SUPREME COURT ISSUES RULING ON COMMISSIONAIRE STRUCTURES AND THE CREATION OF FRENCH PERMANENT ESTABLISHMENTS

► **AFFECTING:**
Businesses conducting activities in France through a commissionaire structure

► **SUMMARY:**
On March 31, 2010, the French Supreme Court released its opinion in the *Zimmer Ltd.* case. The opinion was important for many international businesses that use a French commissionaire sales or similar arrangement. In general, the French Supreme Court held that, for purposes of French law, a company that conducts business through a commissionaire cannot be regarded as a dependent agent with the authority to bind its foreign principal and, as a result, cannot create a permanent establishment in France, even if the commissionaire is actually dependent on the principal. The French Supreme Court's holding in *Zimmer Ltd.* overrules the 2007 decision of the Administrative Court of Appeal of Paris that had caused concern for international businesses using a commissionaire arrangement in France.

► **BACKGROUND**
The taxpayer in the case is Zimmer Ltd., a United Kingdom company, which (for the years at issue) was principally engaged in the design, manufacture, and sale of orthopedic products. Originally, Zimmer Ltd. conducted business and sold its products in France through Zimmer SAS, its wholly-owned French

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subsidiary. Under this arrangement, Zimmer Ltd. and Zimmer SAS entered into a distribution agreement for all French sales. This arrangement was modified in 1995 when Zimmer SAS was converted from a distributor to a French commissionaire. As a commissionaire, Zimmer SAS could generally act in its own name but also on behalf of Zimmer Ltd. The commissionaire arrangement also permitted Zimmer SAS to provide third-party clients with quotes and participate in the bidding process, negotiate price discounts and payment terms and conditions, as well as accept orders from clients. Zimmer SAS could perform these activities autonomously and did not need the approval of Zimmer Ltd. to do so. After entering into the commissionaire arrangement, Zimmer SAS did not perform any other activities in France other than selling Zimmer Ltd.'s products.

The French tax authorities assessed a French corporate income tax liability against Zimmer Ltd. The basis of the assessment was that Zimmer Ltd. had created a permanent establishment in France through the activities of its dependent agent, Zimmer SAS. In January 2005, the Paris tribunal confirmed the position of the French tax administration. Subsequently, in February 2007, the Administrative Court of Appeal of Paris (the "Court of Appeal") upheld the judgment by ruling that it is possible for a French commissionaire to create a permanent establishment in France on behalf of a foreign principal. The Court of Appeal held Zimmer Ltd. had created a permanent establishment in France because Zimmer SAS was conducting business on its behalf as a dependent agent in the country. Moreover, Zimmer SAS could not be viewed as an independent agent because it was generally acting under Zimmer Ltd.'s control for purposes of all French sales and other business activities. The Court of Appeal disregarded the fact that Zimmer SAS could enter into contracts in its own name and perform other business activities without prior approval of Zimmer Ltd. The Court of Appeal also considered the fact that Zimmer SAS did not bear any risk with respect to the sales it made under the commissionaire arrangement.

► FRENCH SUPREME COURT DECISION

The French Supreme Court reversed the decision of the Court of Appeal. In its decision, the Supreme Court looked to Article 94 of the former French Commercial Code (now Article L 132-1), which states that a commissionaire acts in its own name and cannot conclude a contract in the name of its principal. Therefore, the commissionaire does not legally bind its principal because of the contract. What this generally means is that, when a French commissionaire enters into contracts with unrelated third parties, such contracts do not create a direct connection between the third parties and the commissionaire's principal. In conclusion, the Supreme Court held that a French permanent establishment is not created through a commissionaire arrangement. Nonetheless, the Supreme Court noted that a French permanent establishment may still be created through a commissionaire arrangement if the commissionaire enters into contracts with third parties that specifically provide that the principal is bound by such contracts. This is because such a scenario appears to create a direct connection between the third parties and the principal.

► RECOMMENDATIONS

It is recommended that all taxpayers with French commissionaire structures in place review their existing policies and contracts in light of the French Supreme Court's ruling in *Zimmer Ltd.* to ensure a permanent establishment is not created in France.

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