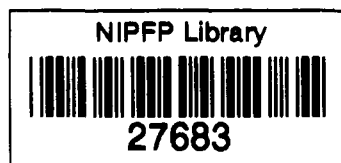


**MANAGEMENT OF VALUE ADDED TAX  
IN FRANCE**

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# MANAGEMENT OF VALUE ADDED TAX IN FRANCE<sup>®</sup>

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## I. INTRODUCTION

One of the factors responsible for proper enforcement of a VAT is organisation of the tax administration. Another important aspect related to the management of a VAT is its operations commencing with registration of taxable persons. All the issues related to the administration of the tax system, e.g. the submission of tax returns, the payment of tax, the audit of taxable persons, the appeal procedure and the cost of administration as well as compliance costs are equally important. Failure to properly administer a tax results in its avoidance and evasion.

As France was the first country to implement a VAT, its tax administration system can serve as an example for countries which have not yet implemented a VAT. In addition, France has a large agricultural sector compared with other OECD countries. More importantly, its treatment of small firms and farmers through the *forfait system* is enlightening. In the light of the fact that the management of VAT in France has had great success in treating "hard-to-tax" groups, this article aims at presenting a case study of France to draw upon some lessons for the developing countries of the world which do not have a VAT.

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Section II of this article analyses the registration process and the obligations of taxable persons, including accounting and declaratory obligations. It also includes a discussion on the processing of tax returns, the information technology for VAT administration and auditing and cross-verification for large and medium-sized entrepreneurs. Section III presents the *forfait* scheme for small enterprises and primary producers.

## **II. REGISTRATION PROCESS AND OBLIGATIONS OF TAXPAYERS**

### **II.A. Registration of taxable persons**

As registration is the prime factor of tax management, all taxable persons subject to VAT must register within 15 days of the beginning of their operations. Taxable persons, for this purpose, are classified into the following categories:

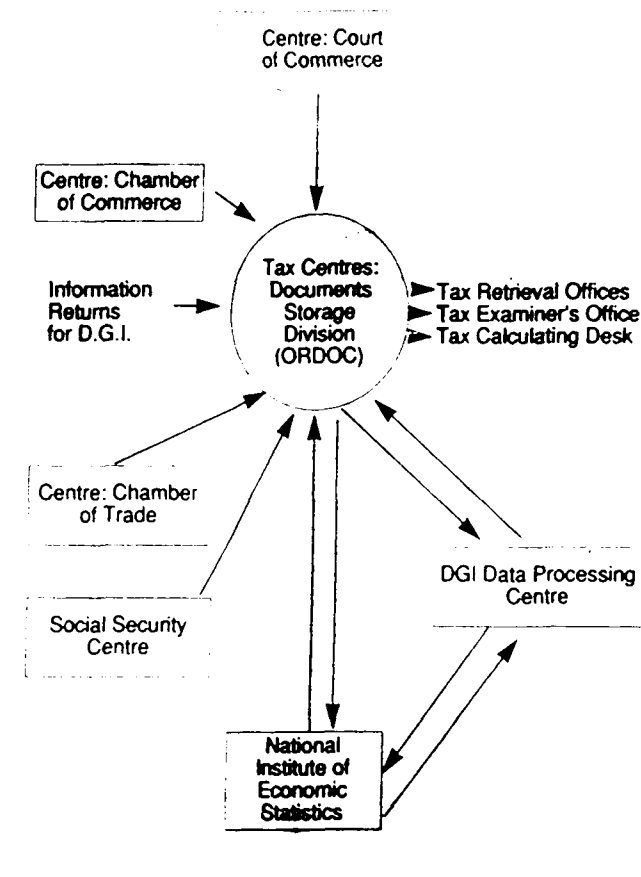
- (a) large enterprises;
- (b) small enterprises; and
- (c) agricultural enterprises or farmers.

The procedure for registration is rather simple. It requires the submission of a common declaration document at the Business Formalities Centre (CEF). The declaration document requests all the necessary information about the taxable person. One copy of this document is sent to each centre of administration shown in Figure 1.

The places where the formalities are to be carried out by taxable persons, according to the category of the business organisation, are set out in Table 1.

Figure 1

FIGURE 1 - REGISTRATION PROCESSES



**TABLE 1**  
**PLACES WHERE REGISTRATION FORMALITIES ARE COMPLETED**

Category of business organizations	Places where the Formalities are Completed
Businesses	Busines Formalities Centre
Traders & Commercial Businesses (except those which are subject to registration in the trade directory) "Groupements d'interet economique"*	Chamber of Commerce and Industry
Craft Businesses Traders & Commercial Businesses also subject to registration in trade directory	Trade Chamber
Associations & Businesses other than Commercial rendering Commercial Aggents	Registry at the Commercial Courts or High Courts judgements in commercial actions
Members of the Professions Other Independent Workers	URSSAF or the General Social Security Fund
Employers whose businesses are not registered in the trade and businesses register or included in the Trade Directory	
If they do not enter any of the above categories Subject to VAT, income tax on the grounds of industrial and commercial profits, or corporation tax in particular: - non-employer non-profit-making associations - renters of furnished accommodation and renters of businesses - joint ventures - farmers placed under the actual basis of subject to VAT	Tax Centre

\* Type of joint venture in France equivalent to but not identical with a consortium.

## **II.B. Obligations of the taxable persons**

As the Department allows tax credits on the basis of the assessment of the taxable person's accounts and the records, a taxpayer has accounting as well as declaratory obligations. These topics are discussed below.

## **II.C. Accounting obligations**

The amount of detail required in the accounting records of a taxpayer depends upon the size of the business enterprise.

### **II.C. 1. Large enterprises**

Taxable persons which supply goods or immovable property with a turnover greater than 3,000,000 Ffrs., excluding VAT, or which supply services with a turnover greater than 900,000 Ffrs, excluding VAT, are required to maintain detailed accounts.<sup>2</sup> All accounting records and invoices must be retained for a period of ten years.<sup>3</sup>

The Code of Commercial Law requires entrepreneurs to maintain journals, ledgers and stock books which provide the basis for their financial statements. The journals and the stock books are to be numbered and initialed.

In addition, the Labour Law requires all employers to maintain chronological payroll records which form the basis for employee pay vouchers.

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2. In addition, the Code of Commercial Law obliges all traders to: (a) record chronologically movements affecting the net worth of their business, (b) control by inventory the existence and value of business assets and liabilities, and (c) draw up annual accounts at the year-end closure including a balance sheet, and a statement of income.

3. However, according to Art. L 82 of the Fiscal Procedures, the registers, books, documents or items concerning the right of communication must be kept for a period of six years.

The General Tax Code sets forth<sup>4</sup> that the accounts have to meet the following requirements. They must:

- distinguish between operations which are taxable and those which are exempt;
- state the nature and the price of each taxable transaction; and
- set forth:
- for each supply of goods or services: the amount of the supply, the amount of the corresponding VAT and the name and address of the supplier; and
- an invoice for each taxable transaction setting forth: the price excluding VAT, the amount and the rate of VAT and the name and address of the supplier.

### **II.C.2. Medium-sized enterprises**

This category encompasses all taxable persons supplying goods or immovable property which have an annual turnover between 500,000 Ffrs., including VAT and 300,000 Ffrs. excluding VAT, or taxable persons supplying services which have a turnover between 150,000 Ffrs. including VAT and 900,000 Ffrs, excluding VAT. A "super-simplified" accounting system exists for such taxable persons, which includes:

- records of daily receipts and payments, and
- yearly recording of accounts payable and receivable. Stock-in-trade and work in progress are assessed according to a flat-rate method.

Medium-sized enterprises are permitted to maintain such accounts provided they utilise a similar system for income tax purposes.<sup>5</sup>

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4. Article 286-3<sup>0</sup> and Annex IV, Articles 37 and 50 quater

5. No. 82-1126 of 29 December 1982, Article 72-1-1

### **II.C.3. Small enterprises and farmers**

Small enterprises which have a turnover that does not exceed 1,000,000 Ffrs. for the supply of goods and 300,000 Ffrs. for the supply of services are exempt from the requirement of producing financial statements to support their VAT returns.

### **II.D. Declaratory obligations**

Declaratory obligations are linked to the assessment procedures which are in turn related to the size of the enterprise. The large enterprise comes under the actual assessment system, the medium-sized enterprise falls under the simplified taxation system, and a small enterprise is assessed according to a notional system. Large taxable enterprises are required to submit a monthly return at the latest on the date set forth by ministerial order<sup>6</sup> except those which:

- engage in a seasonal activity;
- supply goods or services exempt from VAT; and
- firms experiencing difficulties submitting their turnover statements within the regulatory time limits due to the structure of the firms (not allowing centralisation of all the data of the return in time) or owing to an annual closure. In such cases, the concerned taxpayer may be allowed an additional time period of one month. But they must pay, in advance, at least 80% of the sum actually due.<sup>7</sup> The adjustment is carried out during the following month.

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6. This time-table is maintained on the basis of the first letter of the surname of the owner for individual firms and of the two first figures of the identification number allotted by INSEE for companies.

7. In case the advance is less than 20% compared to the sum due, a penalty is payable on the difference between the amount of advance paid and the theoretical advance equal to 80% of the duties due.



A small entrepreneur is required to submit a quarterly return for the notional assessment.

The adoption of any particular system of assessment is based primarily on the size of the enterprise; however, small and medium-sized enterprises have the option to elect to come under a particular assessment system subject to the following conditions:

- assessment is compulsorily made under the same system for both the turnover and the profit;
- businesses normally taxable according to the notional system can opt for the simplified system. An option can only be made for the immediately higher system; and
- businesses falling under the simplified taxation system can opt for the normal system.

The number of taxable persons classified according to the system of taxation, as shown in Table 2, indicates that 83.7% of the taxable persons are under the general system and 16.3% fall under the agricultural system. Out of the general system about 20% fall under the notional basis.

TABLE 2

NUMBER OF DEALERS UNDER VAT IN FRANCE ACCORDING TO SYSTEM  
OF TAXATION SUBJECT TO VALUE ADDED TAX SITUATION  
(AS ON 31 DECEMBER 1987)

A.	Total number		2,826,000
B.	Break down per taxation system		
1.	<u>General system (industrial, commercial, craftsmen, non-commercial professions)</u>		
			Percent
	- notional basis	563,000	(20.0)
	- simplified actual basis	973,000	(34.4)
	- normal actual basis	829,000	(29.3)
	- Total	2,365,000	(83.7)
2.	<u>Agricultural system*</u>	461,000	(16.3)
C.	Breakdown according to the periodicity of their returns and payments		
1.	<u>General system</u>		
	- exempted from payment	54,000	(2.28)
	- quarterly	603,000	(25.50)
	- monthly	1,666,000	(70.44)
	- seasonal	42,000	(1.78)
	Total	2,365,000	(100.00)
2.	<u>Agricultural system</u>		
	- exempted from payment	200	(.04)
	- quarterly instalments and annual regularisation	439,100	(95.25)
	- quarterly	21,700	(4.71)
	Total	461,000	(100.00)

\* 397,200 non-taxable farmers have benefited from a fixed rate agricultural reimbursement in 1987.

## **I. E. Processing of returns**

There are three Departments which deal with the management of the VAT:<sup>8</sup>

1. the Tax Service Centre,
2. the Tax Collector's Office, and
3. the Regional Data Processing Centre, and their relationship is illustrated in Figure 2.

### **II. E.1 Tax Service Centre**

The Tax Service Centre is divided into two departments, which are the List and Forms Section (ORDOC) and the Specialised Inspectorship.

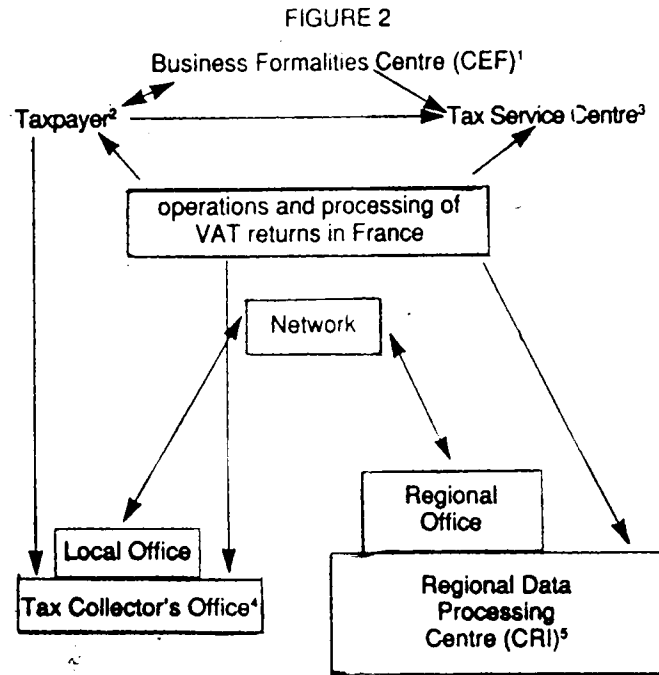
#### *The List and Forms Section (ORDOC)*

The ORDOC is responsible for the lists of taxable persons and file management. The data processing centres (CRI) maintain the permanent taxpayers file (FRP), and the ORDOC updates the FRP. For this purpose it makes use of two documents. First, it utilises the declarations filed with the Business Formalities Centre (CFE) (see Section II. A. above) and second, it gets information from the shuttle bulletins sent to the CRI which set forth information about the creation and the termination of businesses. The ORDOC opens a new file for each new taxpayer and informs the Specialised Inspectorship concerned (see below).

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8. In addition to these three Departments, the Business Formalities Centre (CFE) also involves itself in tax management.

Figure 2



1. The taxpayer may submit his common declaration documents to the CEF or he may contact the ORDOC directly avoiding the CEF.
2. The taxpayer submits his return to the Tax Collector's Office. The interaction between the various departments is indicated by arrows.
3. The Tax Service Centre is organised as follows:  
 ORDOC, i.e. the lists and forms section:
  - maintains lists of taxable persons and does file management;
  - updates the FRP using CFE declarations and getting shuttle bulletins from CRI;
  - maintains registers and directories; and
  - supervises receipt of tax return.
 Specialised Inspectorships:
  - divisions: business tax (FE), personal tax (FP), real estate tax (FI);
  - functions: receives notices of errors from Tax Collector's Office; sends warning to taxpayer; sends return to local department.
4. The functions of the Tax Collector's Office are:
  - accounting and supervising operations; and
  - entry and collection of taxes not paid by due date.
5. Functions of the CRI are:
  - maintains permanent taxpayer file (FRP);
  - checks for errors in tax computation and payment; and
  - sends notice to Tax Collector's Office in event of errors.

In addition to maintaining and updating the taxpayers file the ORDOC keeps various registers and directories. Also, it supervises the receipt of the return. In case of delays in receipt of the tax return, the ORDOC sends reminder notices to the taxpayer which have already been edited by the CRI.

### *The Specialised Inspectorship*

This unit comprises an inspector, a controller and three types of Specialised Inspectorships for:

- business taxation (FE);
- personal taxation (FP); and
- real estate taxation (FI).

Each of these Inspectorships plays an important role in the assessment and operations of the VAT. For instance, the FE inspectorship checks the assessments submitted by taxpayers which, depending on the size of the enterprise, can be submitted on a notional, simplified or actual scheme.<sup>9</sup>

## **II. E. 2. Tax Collector's Office**

The Tax Collector's Office is responsible for the following:

- (a) the accounting and supervision of operations; and
- (b) the entry and collection of taxes not paid by the due date.

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9. With respect to the basis, the FE management inspectorship intervenes for arbitrary assessment in the case where the return is not completed after sending formal demands; taxation of stock; investigation of tax credit reimbursement requests; statistical information of directorates; questions of principle; and various adjustments. Also, for the notional basis, the inspectorship deals with updating the documents necessary to fix the notional basis; the termination, renewal, fixing and notification operations, and the control operations on the spot.

With respect to accounting and supervision, the Tax Collector's Office carries out **two checks**. First, it verifies that the taxpayer has a permanent record and that the return **form** shows the proper registration information. For this purpose, the Tax Collector's Office uses a list prepared by the CRI. If the taxpayer is not registered, the Tax Collector's Office obtains an update from the ORDOC before sending it to the CRI. Second, the Tax Collector's Office ensures that all the information necessary for calculating the tax appears on the tax return.<sup>10</sup>

After this information has been verified, the returns are transmitted to the respective Regional Data Processing Centres (CRI) (see Section II E.3 below). The despatch to the CRI is daily if the returns are accompanied by total payment of the tax due and is monthly for other returns.

If the return is filed after the due date, the Tax Collector's Office specifies the late payment penalties on the return and the CRI prepares a collection notice and sends it to the Tax Collector's Office, which in turn forwards it to the taxpayer.

### **II. E.3. Regional Data Processing Centre (CRI)**

The CRI verifies that computation of the tax liability is correct and that it has been paid. If the CRI detects a calculation error or a discrepancy in the amount of tax due as versus the amount paid<sup>11</sup> the CRI takes corrective action. If the error results in a shortfall, a notice is sent to the Tax Collector's Office, which transmits it to the

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10. The Tax Collector's Office, however, does not verify the calculations. If it points out any anomaly at this stage, there could be two possibilities: first, it can itself rectify the return: it sends the return to the CRI and an "advice" form to the taxpayer and, second, the correction necessitates intervention of the taxpayer, the return is kept pending and an application for information is sent to the enterprise.

11. Computer processing of the returns in France is extremely compact. For details see Purohit, Mahesh C. (1993), *Principles and Practices of Value Added Tax: Lessons for Developing Countries*, Op. cit. Ch.7.

taxpayer.<sup>12</sup>

If errors are found, and the error results in an excess payment, a remark is made on a list of errors, which is sent by the Tax Collector's Office to the Specialised Inspectorship involved (see section II.E.1. above). The Inspectorship checks the corresponding returns and issues a written warning to the taxpayer. The processed returns are then returned to the local Tax Collector's Office.

The regional CRI monitors the submission of tax returns. If there is an error in the return, the CRI prepares a warning to the taxpayer to allow him to correct his return. This warning also enables the tax authorities to monitor the status of the taxpayer's situation.<sup>13</sup>

One copy of the warning is sent to the taxpayer by registered mail with an acknowledgement which the taxpayer must return. When the acknowledgement is returned, it is attached to the second copy of the warning, which is transmitted to the Tax Collector's Office, which determines the penalties to be assessed based on the date of receipt and the financial data on the tax return submitted.

If the taxpayer has not adjusted his tax return after a period of more than thirty days after the date of receipt of the warning, the appropriate Specialised Inspectorship can officially go ahead with the assessment. Alternatively, the tax official prepares the tax return for the taxpayer. The tax official decides the basis and the

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12. There are two copies of this notice. The first copy is sent to the taxpayer who must return it to the Tax Collector's Office after having corrected the mistake. It is then transmitted to the CRI to inform it about the payment of remaining amounts due or the reimbursement of the excess received. The second copy is kept by the Tax Collector's Office until the payment of the remaining amount due or the reimbursement of the excess amount to the company is made. It allows a monitoring of correction of mistakes detected by the Computer.

13. This notice has two copies: the first constitutes the warning, strictly speaking, and the second represents a copy of the notice sent to the taxpayer. It serves, if necessary, to inform the CRI on the errors detected by the Department at the time of inspection of the taxpayer's file.

amount of the tax and indicates this to the defaulting taxpayer. The taxpayer will have to prove that the figures are overstated if he does not agree with the amount of VAT which the Specialised Inspectorship has specified as due.

## **II.F. Cross-verification of documents**

Cross-verification of documents is an essential component of proper tax administration and without it a taxpayer could have an incentive to avoid the payment of tax and claim credit for taxable sales which have not in fact occurred. It is, however, not possible to cross-verify all invoices for all taxpayers.

France has a centralised anti-evasion organisation called the Directorate of Verification, which investigates enterprises with a turnover of over 300 million Ffrs. Its authority extends to both national and international enterprises. This organisation functions at the national level and obtains information from all the regional tax offices for possible cases of fraud. Fraud investigations are carried out on the basis of the type of industry or trade. A particular type of trade is investigated thoroughly at any specific point of time. There are also regional Directorates of Verification which examine enterprises with an annual turnover of up to 300 million Ffrs.

In addition, there is a National Directorate of Fiscal Enquiries (DNEP) and a Fiscal Police (BCR) which investigate cases of fraud or fake invoices. Normally, these investigations (including cross-verifications) do not exceed an analysis of the tax returns of 1% to 2% of the total taxable persons in the country. The marginal cost incurred in cross-verification compared to marginal gain is always kept in mind.<sup>14</sup>

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14. Cross-verification of tax invoices has been attempted at great length in the Republic of Korea. In 1978 they processed approximately 112 million tax invoices. It was, however, found that cross-verification of all such invoices does not yield expected results. The number of cases cross-verified had, therefore, been reduced in the later years and since June 1980 cross-verification has been limited to invoices exceeding 3,000 won.



## **II.G. Auditing VAT returns**

Auditing VAT returns attempts to minimise the gap between the reported tax liability and the actual statutory tax liability of taxpayers. The audit plan is normally as broad in coverage as possible. It attempts to cover different economic activities and a large variety of taxpayers classified by the amount of their annual turnover. Also, it includes different procedures to identify and deal with non-compliance.

Since a VAT audit of an enterprise on a comprehensive scale is neither economical nor administratively feasible, as is the case in most other countries, France has a system whereby it audits selected taxpayers. The number of such taxpayers selected for audit depends, however, upon the method of evasion of tax and the normal system of tax compliance.

The audit system is based on the number of cases selected for audit. Normally, the following criteria are adopted. First, not too much of the audit time should be devoted to the scrutiny of large taxpayers. In some countries tax audit staff have been assigned almost exclusively to the audit of large taxpayers. Such a policy may lead to unwanted results in terms of increasing the concentration of collection among a few taxpayers. On the other hand, the policy of the administration to spread its tax audit activities amongst many small taxable persons is not economical. It is, therefore, necessary to have a mixture of both these policies.

Secondly, a selective system should be followed to designate taxpayers for audit. Hence, the type of economic activity engaged in by the taxpayers, its sales volume, reported annual mark-up and discrepancies resulting from cross-checks through appropriate information systems, etc. should be considered while selecting cases for audit. And, finally, a mechanism should be developed to ensure that taxable persons who have not been audited during the last few years are included.

Considering all these criteria, the tax management of VAT in France covers all companies for audit once in five years. Other taxable persons who get into the audit net constitute between 5% and 10% of the total every year.

## **II.H. Tax compliance**

Compliance with VAT in France is considered to be relatively good, particularly when it is compared with compliance with other forms of sales taxes. Nevertheless, there is a fair amount of tax evasion which takes place through the operation of a parallel economy. The evasion takes place through use of the following devices:

- enterprises concealing transactions by use of the "black labour" market, e.g. in the construction industry, ready-to-wear textiles, hotel and restaurant industries; and
- unreported transactions by employees in the public sector (e.g. plumbing and painting) where payment is often made in cash.

In addition, there are other forms of tax evasion which include the following:

- production of invoices for fictitious purchases in order to obtain a refund of input tax;
- underestimation of sales of small enterprises; and
- non-reporting of secondary activities of larger enterprises.

It is evidently a difficult task to estimate the quantum of tax evasion with any degree of accuracy but the Sixth Report of the Tax Council to the Republic<sup>15</sup> used

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15. The Tax Council (1983), *Sixth Report to the President of the Republic on Value Added Tax*, Paris.

national accounts and the input-output tables to estimate the potential tax yield for VAT. This was compared to the actual VAT yield and the difference was labelled as the "VAT Discrepancy". This discrepancy was then adjusted to take account of legal exemptions from taxation, time lags and other features of the system and the residual factor was taken as an indication of evasion. The estimates, as presented in Table 3, suggest that VAT revenue losses were ranging between 6.6% and 10%. However, over the years this percentage has declined.

### **III. TREATMENT OF SMALL FIRMS AND FARMERS**

#### **III. A. Introduction**

Small entrepreneurs have a special place in VAT management. As these entrepreneurs are large in number and unable to comply with the accounting and procedural requirements which apply to large and medium sized enterprises, it is not possible to treat them in the same manner that other businesses are treated. It is also not advisable to leave them out of the tax net. A special treatment for them is, therefore, provided by most countries. France being pioneer of VAT provides for a comprehensive scheme for small entrepreneurs. The details of the lump-sum taxation (*forfait*) for small entrepreneurs and the French simplified system for small farmers called RSA (*Régime spécifique de l'Agriculture*) are the topics of discussion in Section III of this article.

TABLE 3

DISCREPANCIES RECORDED BETWEEN ACTUAL COLLECTION  
AND HYPOTHETICAL YIELD OF VAT ON  
GOODS AND SERVICES

(‘000 million francs)

Years	VAT discre- pancy	Portion attri- butable to exemption rebates and book differ- ences	Residual discre- pancy	As % of VAT revenue	As % of GDP
(1)	(2)	(3)	(4)	(5)	(6)
1970	9.1	1.8	7.3	10.3	0.9
1971	10.3	2.2	8.1	10.2	0.9
1972	10.2	2.2	8.0	8.9	0.8
1973	10.5	2.0	8.5	8.8	0.8
1974	12.2	2.8	9.4	8.2	0.7
1975	13.2	3.0	10.2	7.5	0.7
1976*					
1977	19.5	5.7	13.8	8.9	0.7
1978	17.3	4.4	12.9	7.1	0.7
1979**	14.5	2.5	12.0	5.6	0.6
1980**	20.3	5.2	15.1	6.2	0.6
1981**	24.0	5.9	18.1	6.6	0.7

\* In view of statistical lag, only the average of the figures for the two years is significant.

\*\* Provisional accounts.

Source: Institute National de la Statistique et des Etudes Economiques (NSEE)

### III.B. *Forfait* for small entrepreneurs

This system applies a lump sum tax liability for a small firm with an annual sale of goods or the provision of hotel services under 500,000 Ffrs., or for other services under 150,000 Ffrs. and for supplies in connection with the perfume industry under 175,000 Ffrs. The tax liability is estimated on the basis of a *forfait* (i.e. the tax is calculated on the basis of a mutual understanding between the entrepreneur and the tax administration, rather than by an actual calculation of tax due on sales and the tax paid on purchases).

Firms with a tax liability of between 1,350 Ffrs. and 5,400 Ffrs. receive partial reduction of their tax liability. Partial relief is also provided to firms in the "artisan" group, for which labour constitutes over 35% of sales, when the tax liability is between 1,350 Ffrs. and 20,000 Ffrs.

Small firms which have a VAT liability of less than 1,000 Ffrs., are authorised to submit their returns on a quarterly basis. Taxpayers who had a tax liability of less than 12,000 Ffrs. in the previous year may elect to come under this system.

Firms whose annual tax liability is less than 1,350 Ffrs. can be granted an exemption from VAT. These firms are registered and they invoice tax on their sales to purchasers so that the latter may obtain credit for the tax paid against their tax liability. The exempt firms must file annual returns.

It is estimated that in 1984 out of a total of 2.17 million registrations, 66,000 (or 3%) are completely exempt; they account for only 0.3% of potential tax revenue. A large number of small service and repair shops, which account for some 435,000 or 18% of the total, are eligible for the special artisan treatment. In all, 724,000 firms receive *forfait* treatment and 760,000 are subject to a simplified calculation (RSI) system.

### III. C. Simplified system for small farmers

Farmers with annual sales of 300,000 Ffrs. may opt out of the regular system. Such a farmer would charge tax on his sales but may claim reimbursement for the tax paid on inputs. Farmers with sales above 300,000 Ffrs. (and also those smaller farmers that wish to opt in) are required to be registered but are subject to a simplified system, known as RSA (*Regime Specifique de l'agriculture*). These farmers collect tax on their sales, file an annual return, and pay tax quarterly. They are required to keep only simplified records of purchases and sales. The tax return for these taxable persons is also very simple. The number of enterprises subject to the simplified system has risen steadily from 220,000 in 1971 to 440,000 in 1984. On the contrary, the number not opting for RSA (and receiving tax reimbursement) fell from 660,000 in 1976 to 480,000 in 1984.

Small taxable persons with a turnover not exceeding 500,000 Ffrs. (inclusive of all taxes) for the supply of immovable property, or 150,000 Ffrs. (inclusive of all taxes) for other activities, are entitled to pay their VAT on a lump-sum basis.<sup>16</sup>

### III. D. Procedure for lump-sum fixation

Taxable persons entitled to pay their tax on a lump-sum basis are required to apply to have the lump-sum amount set. While waiting for such a fixation, the taxpayer is required to make provisional payments to the Tax Collector's Office, equal to one fourth or one twelfth of the net tax resulting from the previous lump-sum amount (this does not take into account the VAT on investments) depending on whether the amount is less than 12,000 Ffrs. per year. Payments are made quarterly if the tax liability is less than 1000 Ffrs. per month; if it exceeds this amount, tax payments are to be made monthly.

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16. However, these taxpayers should not have been excluded from this system because of their legal form or the type of their operations. Also, they should not have opted for the simplified taxation systems

In order to fix the lump sum, the Department takes local conditions into account. Similarly, it considers the "fiscal fabric" of the taxpayers<sup>17</sup>. A study of the taxpayer's files can be followed by a field visit to verify the impressions gained from the available data.

The following taxable persons are examined on a priority basis:

- taxable persons belonging to sectors benefiting from expansion;<sup>18</sup>
- taxable persons having activities of a type where it is difficult to determine profits;<sup>19</sup>
- taxable persons who have been declaring a turnover close to the limits of the lump sum for many years;
- taxable persons whose lump-sum amounts have been fixed earlier on the basis of the counter-proposal of the taxpayer in the absence of adequate details; and
- taxable persons whose movable or immovable property increases very significantly.

In addition to the general criteria, some special criteria are adopted. These include a comparative study of accounting data, profits and losses and the property of the taxable persons.

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17. This includes all the conditions under which the profession is exercised. For example, location of the shop, arrangement, items sold, prices practised and major modifications likely to have an influence on the turnover and its results.

18. This includes recreation, traders in sports or gardening material, bicycles and motorcycles and road transport.

19. These areas include: taxis, antique dealers and free-lance workers.

A comparative study of accounting data often enables one to detect a cyclic change in the turnover (Turnover of N+1<sup>20</sup> and turnover of N years<sup>21</sup>), stocks (amount and speed of rotation), rates of margins and percentages of gross profits which can only be explained by the desire to alter the results of the company pertaining to the first year of the two-yearly period. This criterion works out very well, especially because the anomalies can be quite easily detected by studying tax returns and the assessment files.

A comparative study of profits is extremely useful. The profit must match with:

- details of the life style of the taxpayer (personal movable or immovable assets, repayment of loans, etc.);
- Salaries paid in the company; and
- number and life style of persons living in the household.

It is unlikely that the benefits of the head of the company are less than those of his best paid worker or that the benefits of the company head increase at a lower rate than that of the company's employees.

Also, an analysis of the balance of personal property of the taxpayer reveals certain facts. With the help of available information, a brief analysis of the taxpayer's finances is prepared for certain files and for those files where the information is considered incoherent or inadequate. This "personal property balance" allows the tax administration to determine a presumed net profit which helps to reconstitute the turnover to be notified, while taking into account the consumed purchases, miscellaneous expenditures and the depreciation costs.

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20. Turnover of the second year of the two-yearly period.

21. Turnover of the first year of the two-yearly period, i.e. the one which actually serves as reference for determining the lump sum.



Accounting obligations for these taxpayers, according to the General Code of Taxes, consist of maintaining a purchase book supported by invoices or justifying documents. Companies whose activities concern operations other than sales are required, additionally, to have a daily journal giving details of their professional receipts pertaining to these operations.

Declarative obligations of these taxable persons consist of submitting a simplified annual return to the tax department giving information about their turnover.<sup>22</sup> The blank returns (in triplicate) are sent directly by the computer centres to the taxpayer which must be submitted (in duplicate) at the latest by 15 February of the following year. This date limit is extended to 30 April when it concerns the second year of a two-yearly period.

Defaulting taxable persons are followed up by the tax department and are subjected to the usual manual procedure of assessment. Also there is a provision of fines for 25 Ffrs. or 200 Ffrs. per document for omitted information depending upon the effective date of the submission of the return.

### **III.E. Verification of accounts**

The administration selects, from each type of trade, one or more files showing serious anomalies. They then obtain a list of the taxpayer's suppliers and send an officer to the suppliers who records, from 1 January of the following year, the complete data of purchases for several years. The information thus obtained is then reconciled with the data shown on the return form.

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22. The information in the return relates to the following:

- on the front page, name and details concerning the company (date of establishment of the company, registration number on the list of professions, address, name and address of the advisor, vehicles used),  
and
- On the back page, the necessary details required to determine the lump sum amount.

The information should be given, in principle, 'inclusive of taxes', which enables one to know about the fulfilment of the legal limits. The company can indicate, provided the accounts permit it, the amounts net of VAT and the corresponding tax.

This could be complemented with a series of searches to be carried out in one or many professions (or activities) selected from the sectors where the likelihood of discrepancies is the most probable (e.g. traders in bicycles, motorcycles, radios, televisions, gardening products, paints, flowers, and clothing and shoes).

### **III.F. Administration of the lump-sum payment**

The lump-sum taxpayers are required to furnish precise information on the return. On the basis of the details given in the form, the Department decides the criteria and the amount of tax, according to the procedure explained below.

The lump-sum VAT, in principle, is decided for a period of two years. For the first year of the period, it is assessed based on the prior year's information furnished by the taxpayer on his return. For the second year, on the contrary, the lump sum is an estimate based on the economic climate and the expansion possibilities of the company. In principle, an upward trend should be noticed with respect to the first year representing at least the increase in the cost of living.

#### **III.F.1 Reconstitution of the turnover**

First year of the bi-annual period: The information provided in the return form is analysed to assess the correctness of the return. For this purpose, the margin of the taxpayer is compared with that usually made in similar companies, and which is drawn from monographs.<sup>23</sup> Other elements useful to have as a basis for a reconstitution are salaries paid, materials utilised and products purchased.

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23. From the monographs the Department gets information on the technical and commercial characteristics of the enterprises which concern them and this information is communicated to the professional organisation which may make remarks.

It is important to note that the coherence and a set ratio of the company's expenses, etc. are not a guarantee that details on the form are correct. Data can be falsified proportionately. Hence, what is important is the relationship between the business turnover and profit declared to the tax authorities, with the details of the life style of the taxpayer as studied over a long period of time. This could be verified with the help of information contained in the taxpayer's file.

When the domicile of the taxpayer is located outside the jurisdiction of the tax office which manages the professional activity, a systematic and periodical liaison maintained between the two Departments. This liaison is ensured through a special liaison bulletin prepared in such a way so as to give easy indications on the taxpayer's life style.

### **III.F.2. Calculation of the tax**

From the reconstituted turnover, the Department determines, for each year, the amount of the net VAT by calculating gross VAT minus deductibles. If necessary, the investments are taken into consideration for determining the lump sum of the first year of the period. As regards the second year of the period, the gross VAT and the deductible VAT from goods other than immovable property and services are evaluated with reference to the first year to which a progression coefficient, to be determined according to forecasts of the operation of the business retained by the Department is applied.<sup>24</sup>

### **III.F.3. Procedure for renewal of the lump-sum tax**

The procedure for renewal of the lump-sum tax is basically a contradiction-verification procedure. The first phase comprises giving notice for termination. In the absence of a notice (at the latest by 15 February by the taxpayer, and at the latest by 31 March by the Department), the lump-sum amounts are automatically renewed for a year.

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24. Investments are not taken into account for establishing the lump-sum amount of the second year, for two reasons: first, they are not always known nor realized at the time of fixing the lump sum; and second, they may tend to falsify the amount due at maturity and the provisional instalments; this can cause a considerable adjustment at the conclusion of the next lump-sum period.

However, when a notice is given by the taxpayer after examining the return of the year N, submitted before 16 February of the year N+1, the Department decides on the opportunity of giving notice of lump sum for the year N-1 so as to avoid its renewal in the year N.

The second phase has two distinct procedures, viz. the normal procedure and the simplified procedure. In the normal procedure, the lump-sum amount is notified with the help of a form which is a set of four sheets having different colours: (1) green, (2) pink, (3) yellow, and (4) white. These four sheets are adopted to complete the overall procedure.<sup>25</sup>

At this stage of the first proposal, the taxpayer receives a notice by registered mail. The front side of the form indicates various boxes pertaining to the procedure to be followed, according to his agreement with the notified elements. Two boxes are designated for his signature. On the back side, box I indicates the amount of lump sum of profit for each of the two years of the bi-annual period. Box II is meant for transcription of the elements agreed upon in the matter of VAT. The other forms of the set serve as verification bulletins and are filed along with other procedural documents (duplicate copy of the letter giving notice of termination).

As against normal procedure, the simplified procedure is applied when (i) assessment of various elements of taxation brings forth a net annual tax, which is hardly different from the lump sum; and (ii) when the amount of the tax normally due does not exceed the limit of exemption.

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25. The different sheets of the form are as follows:

- (1) first notification of taxation details;
- (2) second proposal of taxation details;
- (3) notification of taxation elements finally decided; and
- (4) used for levying of tax on income (internal liaison).

The front page of each of the first three sheets is a letter addressed to the taxpayer, adapted to each stage of the procedure. The elements of taxation proposed or notified are indicated on the back page of each of the sheets through chemical duplication; the lines where assessment of the lump-sum amounts are to be written are doubled so as to allow any latter adjustments under discussion without burdening the elements previously notified. This provision also enables limiting of new writings to the modified elements only and keeping a trace of successive proposals.

The third phase involves the notice sent to the taxpayer. The taxpayer has to send his reply within a period of 30 days. There are three possibilities. First, the taxpayer sends back the notification form bearing his acceptance. Second, if the taxpayer does not reply within thirty days, the lump sum is decided by tacit approval. And third, the taxpayer expresses his disagreement (on one or two years) and makes a counter-proposal. If the counter-proposal is accepted by the Department, a new lump sum is decided; the Department then mentions the new details of the assessment. If these are rejected by the Department, the latter may, however, like to modify the initial assessments. In this case, the second proposal is notified. If the taxpayer accepts the second proposal, the lump sum is concluded on this basis. In the absence of an amicable acceptance, the lump sum is fixed by the departmental Commission of Direct Taxes on Turnover.<sup>26</sup>

The fourth phase comprises the right of the taxpayer to contest the lump-sum amount which the Commission has fixed. In this eventuality, the onus of proof would be on the taxpayer to produce the accounting documents and all other proofs that the basis decided by the Department is too high.

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26. It is a body where both the Department and the taxpayers are equally represented. It is composed of three members representing the taxpayer (two professionals and one chartered accountant), two government servants from the tax department of at least the rank of chief inspector, representing the administration; a magistrate of the Administrative Court, the President, who, in the event the vote is equally divided, has the deciding vote; and an officer of the tax department looking after the secretariat of the Commission and having a consultative vote. The proceeding could be started at the initiative of the taxpayer or the Administration. The taxpayer can directly seize the Commission or can do it through the Administration for the observations made in response to the proposals of the Department. This could also be done by the Administration. In case it is done by the Administration, the officer not in agreement with the taxpayer sends the file on the case to the Secretariat of the Commission through his head office. A report explaining the mode determining the lump sum, the points under dispute and all information or arguments likely to provide clarifications to the Commission are enclosed with the above. The report and the documents used by the Administration to reinforce its argument are sent to the taxpayer through the secretariat of the Commission who keeps them at his disposal for at least 20 days before the meeting of the Commission. With the help of written information provided to it, and if necessary, after having heard the parties present, the Commission decides the lump sum (turnover or profits or both) for the bi-annual period as well as the VAT and deductions. It must give a reasoned advice. This advice and the yellow copy of the form referred in footnote 24 above (proposed assessment) are then notified to the taxpayer under a registered cover with acknowledgement.

### III. G. Follow-up action by the Department

Once the lump sum is decided, the Specialised Inspectorate transmits the information to the Department which collects the tax for an adjustment of their records. The Department also prepares a form<sup>27</sup> giving the basis for this level of taxation.

### III. H. Special cases of new taxpayers under the lump-sum tax

New taxable persons under lump-sum VAT are required to make provisional payments.<sup>28</sup> In order to fulfil this obligation, the taxable persons are required to complete the relevant portions of the return.<sup>29</sup>

The lump-sum liability is fixed after taking into account the totality of elements which allows one to appreciate the clear situation of the taxpayer. After the calculation of the lump sum, the taxpayer makes payment for adjustments and then pays the lump sum in instalments equal to one fourth (or one twelfth) of the net tax resulting from the new lump sum

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27. Description of the form is as follows:

*Front side:*

Box I has the preprinted information on the lump-sum taxpayer and the corresponding codification (number of the Tax Collector's Office, file etc.)

Box II gives in a synoptic manner the essential characteristics of the taxpayer's situation as regards the lump-sum taxation. This box is also meant for putting down different information shown on the annual return of the first year of the period. Details of figures characterising the lump-sum amounts for the bi-annual period shall be written in box V.

*Back side:*

Special annotations (verification) are to be written there. Box IV indicates the deductions granted in payment and box IV *bis* gives reductions or modifications in provisional payments.

28. Unless a permission has been obtained from the Department authorizing them to make regular provisional payments, the concerned parties must calculate these payments on the basis of the actual turnover to which a specific coefficient is applied on the basis of their business forecasts.

29. However, they could furnish a detailed break-up of the tax due by using the boxes A and E of this form, normally reserved for companies placed under the system of "real normal". Of course, this choice once exercised at the time of the first submission of the return must be maintained for all the forms submitted till the fixation of the first lump sum.

(second year of the period). The taxpayer is required to ensure compliance with these obligations; any late payment will be sanctioned by a late payment interest (0.75% per month) and an increase in the lump sum of 5%.

However, the action to be taken at the time of the renewal of lump-sum amounts upon expiration can vary according to the size of the taxpayer and the amount of tax involved. The renewal could be made for taxable persons whose turnover is less than 200,000 Ffrs. (sales) or 75,000 Ffrs. (services) after a brief study of details of the file (i.e. life style, changes in turnover). On the other hand, the renewal for other companies is made after a critical and exhaustive examination of the details of the return and the contents of the file.<sup>30</sup>

#### IV. CONCLUSION

Management of VAT in France covers the desired objectives of tax administration. It commences with the registration of taxable persons, which is compulsory for all types of trade. Once registered, the taxpayers' obligations in submitting the returns (declarative obligations) and procedures in maintaining books of accounts (accounting obligations) differ on the basis of activities (i.e. agricultural or business concerns) and volume of turnover (i.e. small, medium-sized and large enterprises).

Methods of assessment also change according to the category of the taxpayer. Farmers have the option of submitting monthly, quarterly or seasonal returns. Business enterprises are subjected to the notional basis, the simplified actual basis or the normal actual basis, according to the volume of their turnover.

The system of *forfait* (lump-sum taxation) in France is critical for tax management. It is relatively complex. However, it offers various advantages to the taxpayers regarding their obligations. Moreover, the tax maintains an evaluative character. Since 1978, the tax rebates (exemptions, deductions) earlier offered only to those coming under the lump-sum system have now been extended to taxable persons who are opting for the simplified taxation system.

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30. It may be pointed out that the limits of figures mentioned above are only indicative.

