

www.pwc.com/internationaltp

International Transfer Pricing 2013/14

*An easy to
use reference
guide covering
a range of
transfer pricing
issues in nearly
80 territories
worldwide.*

pwc

www.pwc.com/tptogo

Transfer pricing at your fingertips.

pwc



For up-to-date information from PwC's leading transfer pricing publications, download *TP to Go* from your app store now. *TP to Go* is free to download on iOS, Android, and Blackberry. Once installed, it checks automatically for new content every time it starts.

73.

Turkey

Introduction

Specific transfer pricing rules are valid in Turkey as of the beginning of 1 January 2007 under Article 13 of the Corporate Income Tax Law (the CITL) No. 5520 with the title 'Disguised Profit Distribution through Transfer Pricing'.

The regulations under Article 13 follow the arm's-length principle, established by the Organisation for Economic Co-operation and Development Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD Guidelines), and are applicable to all financial, economic, commercial transactions and employment relations between related parties. Details on the application of Article 13 are provided in a communiqué regarding disguised profit distribution through transfer pricing.

Statutory rules

The legal framework that defines the current Turkish TP implementation methodology is included under the CITL and the related communiqué(s).

The Turkish TP legislation is part of the Turkish CITL. The arm's-length principle, which is defined in line with OECD Guidelines and Article 9 of the OECD Model Tax Convention, is enacted in Article 13 of the CITL along with a detailed definition of related parties, as well as the introduction of methods to be applied in the determination of the arm's-length price. According to the law, related parties must set the transfer prices for the purchase and sales of goods and services as they would have been agreed between unrelated parties.

A comprehensive definition of what constitutes a related party is found in Article 13 of the CITL. Related party definition of the Turkish Transfer Pricing regulations is very broad and it includes direct or indirect involvement in the management or control in addition to the existence of shareholder/ownership relationship. In addition to transactions with foreign group companies, it also includes transactions with entities that are based in tax havens or in jurisdictions that are considered to be harmful tax regimes by the Turkish government.

For the purposes of the CITL, the term 'corporation' covers:

- capital stock companies
- cooperatives
- public economic enterprises
- economic enterprises of associations or foundations, and
- joint ventures.

Turkey

Within this framework, the concept of ‘related party’ is broadly defined under Article 13 of the CITL No. 5520 as follows:

- Shareholders of the corporation (without any threshold).
- Legal entities or individuals related to the corporation or its shareholders.
- Legal entities or individuals which control the corporation directly or indirectly in terms of management, supervision or capital.
- Legal entities or individuals which are controlled by the corporation directly or indirectly in terms of management, supervision or capital.
- Spouses of shareholders of the corporation.
- Ascendants and descendants of shareholders or their spouses.
- Persons who are linked to shareholders or their spouses up to third degree by direct blood relationship or marriage.

Moreover, by taking into account whether the taxation capacity of the source country (the tax burden on corporate income earned in the source country to be measured by taking into account all taxes that are similar to personal and corporate income taxes) is the same with that of Turkey and the issue of exchange of information, transactions made with persons located in regions or countries to be announced by Council of Ministers will be deemed as if they were made with related parties.

The Transfer Pricing rules define certain methods for the determination of arm’s-length transfer prices. The methods adopted are comprehensively explained by the OECD Guidelines and are as follows:

- Comparable uncontrolled price method.
- Cost plus method.
- Resale price method.

The law states that if the above-mentioned methods cannot be used by the company for certain situations, the taxpayer will be free to adopt other methods. This means companies can also choose other methods such as the transactional profit methods of the OECD Guidelines (namely, profit split and transactional net margin method) for the determination of the arm’s-length price, if they can prove that the above-mentioned traditional transaction methods cannot be used.

According to the General Communiqué No. 1, the other methods are defined as the following:

- Profit split method.
- Transactional net margin method.

If none of the aforementioned methods can be applied, the method determined by the taxpayer may be used as the most appropriate method for the transactions.

Comparable uncontrolled price method

In the comparable uncontrolled price method (CUP), if the internal comparables are sufficient to reach an arm’s-length price, there is no need to find an external comparable. If there is no internal comparable, external comparables should be used after making a comparability analysis and the necessary adjustments.

Cost plus method

In the cost plus method, all the direct costs, indirect costs, common costs related to service or product and operation costs should be considered.

If there is a difference between the accounting systems of related and unrelated transaction processes, the necessary adjustments should be made.

Resale price method

The resale price method evaluates the arm's-length character of a controlled transaction by reference to the gross profit margin realised in comparable uncontrolled transactions, and is most useful where it is applied to marketing operations, such as distributors.

Profit split method

The profit split method is based on the distribution of the operating profit or loss among related parties according to their functions performed and risks assumed.

Transactional net margin method

The transaction net margin method (TNMM) is applied according to the net operating profit margin that is found by considering the costs, sales or any other appropriate base.

Tax havens

In addition to inter-company transactions between related parties, the transfer pricing provisions of the CITL cover transactions between unrelated parties, where the foreign party is located in one of the tax havens to be identified by the Turkish Council of Ministers. However, such a list has not been published yet as of 30 September 2012.

Payments for services, commissions, interest and royalties to parties located in a tax haven are subject to a 30% withholding tax under the CITL. However, if the transactions involve the import of a commodity or the acquisition of participation shares or dividend payments, the withholding tax is not applicable as long as the pricing is considered to be arm's length.

Deemed dividends

When it is determined by tax inspectors that the price applied in a related party transaction is not at arm's length, the outcome is a tax adjustment on corporate tax as well as additional dividend tax on the disguised profit distribution. This requires that if the counterparty is a non-resident taxpayer, individual or any tax-free person; corporate dividend tax should be paid over the disguised profit distribution.

Adjustments

Any transfer pricing-related adjustments deemed necessary by the tax inspectors will be made to the taxpayers' earnings after they pay their respective corporate taxes.

Disguised profit distributions through transfer pricing are not accepted as deductible for CIT purposes. The corporate tax base of the taxpayer will be adjusted, and relevant corporate tax will be calculated together with the penalties and late payment interest.

Besides, the disguised profit which is wholly or partly distributed to a related party will be treated as:

Turkey

- deemed dividend, if the corporation distributing the disguised profit is a resident taxpayer,
- remittance, if the corporation distributing the disguised profit is a non-resident taxpayer.

In both cases, the amount of disguised profit will be subject to a withholding tax.

However, pursuant to Article 5(1)(a) of the CITL No. 5520, if the related party receiving the disguised profit is a resident corporate taxpayer, the disguised profit will be evaluated within the context of 'participation exemption'. Accordingly, no withholding tax will be imposed and adjustment will be made on the tax return.

Documentation requirements

The legislation requires documentation as part of the transfer pricing rules wherein Turkish taxpayers should keep documented evidence within the company in case of any request by the tax authorities. The documentation must represent how the arm's-length price has been determined and the methodology that has been selected and applied through the use of any fiscal records and calculations, and charts available at the taxpayer.

The transfer pricing regulations in Turkey have three basic documentation requirements:

- Electronic corporate tax return form about transfer pricing, controlled foreign company and thin capitalisation.
- Annual transfer pricing report.
- Transfer pricing documentation for taxpayers during the application of an APA and annual report for taxpayers under an APA.

According to General Communiqué No. 1, all corporate taxpayers should submit a form as an attachment to their annual corporate tax return. The form constitutes the following parts:

- Information about the taxpayer (tax ID number, corporate name, taxation period, etc.).
- Information about the related parties within the scope of the form (corporate name, country of residence).
- Total amount of transactions that occurred between related parties.
- The methods used for the related party transaction.
- Information about the controlled foreign company of the company (corporate name, country of residence, etc.).
- Information about thin capitalisation.

On the other hand, corporate taxpayers are obliged to prepare an annual transfer pricing report in line with the format that is stated in the General Communiqué No. 1. An annual transfer pricing report should be prepared until the last day of CIT declaration day, which is 25 April for taxpayers whose fiscal year is calendar year. The report shall compose different levels of information depending on:

- whether the taxpayer is registered to the Major Taxpayers Tax Office, and
- whether the taxpayer is operating in free trade zones in Turkey.

According to the above-mentioned distinction:

- corporate taxpayers that are registered to the Major Taxpayers Tax Office shall prepare a report that comprises information about both their domestic and cross-border related party transactions, and
- corporate taxpayers that are operating in free trade zones (FTZ) in Turkey shall prepare a report that comprises information about their transactions with their related parties in Turkey.

All other Turkish corporate taxpayers shall prepare a report that comprises information about their cross-border related party transactions.

Documentation deadlines are as follows:

	Preparation deadline	Submission deadline
Transfer pricing form		Corporate tax return submission (as an attachment to the corporate tax return) on the 25th day of the fourth month following the end of the fiscal year
Annual transfer pricing report	Corporate tax return submission on the 25th day of the fourth month following the end of the fiscal year	15 days upon request

Disposition of the annual transfer pricing report is mentioned in the related legislation as follows:

- General information: Information about the field of activity of the taxpayer, economic conditions in this field, market conditions and business strategies.
- Information about related parties: Information about tax ID numbers, addresses, telephone numbers, etc. of the related parties and the field of activity of the related parties as well as economic conditions in this field, market conditions and business strategies, functions they generate, risks they assumed and assets they owned.
- Information about the details of related party transactions: Detailed information about all transactions and agreements between related parties.
- Information about transfer pricing analysis: Detailed information about comparability analysis, criteria that are used to choose for the comparable transactions (whether there are corrections on determination of the comparability the detailed information for that; information, documentation and calculation that shows the applied TP method is the most suitable as well as the comparison of the applied method to the other methods; detailed information about the calculations used to find the arm's-length price or profit margin; whether an arm's-length price range is determined, and the detailed information on this range).
- Conclusion: A summary includes the methods and arm's-length prices of the intercompany transactions.

Taxpayers that apply for an APA shall prepare application documents, and once an APA is concluded with the Revenue Administration, the taxpayer shall prepare a separate annual report that takes transfer pricing into consideration from the APA's

Turkey

point of view. The documents and information required for the annual report of APA is separately defined in the legislation.

The administration can demand additional information and documents for the annual transfer pricing report, the APA application and other corporate taxpayers that have related party transactions when deemed necessary. If the documents are written in a foreign language, their translation into Turkish is obligatory.

Other documents

Corporate and individual income taxpayers must prepare transfer pricing documentation. The type of information that is required is outlined in General Communiqué No. 1 as follows:

- Organisation chart and definition of the company's activities, definition of related parties (tax ID numbers, addresses, telephone numbers, etc.) and property relations amongst them.
- All the information that includes the functions undertaken and the risks assumed by the company.
- The product price lists in the transaction year.
- The production costs in the transaction year.
- Invoice information and the number/value of transactions made with related or unrelated parties in the transaction year.
- All the contracts with related parties in the transaction year.
- Financial statements of the related parties.
- Internal pricing policy of the company, which is applied to related party transactions.
- The associated information if related parties use different accounting standards and methods.
- Information related to the ownership of intangible property and amounts received or paid for intangible rights.
- Reason for choosing the transfer pricing method applied and informative documents related to the application of the transfer pricing method (internal and/or external comparability analysis).
- Calculations used to determine the arm's-length price or profit margin and detailed information related to assumptions.
- Method used to determine the arm's-length price range, if any.
- Other documents used to determine the arm's-length price.

Language for documentation

TP documentation should be prepared in Turkish.

Other regulations

In addition to the specific transfer pricing regulations, additional requirements or rules covering transfer pricing contained in other legislation include:

- Turkish tax procedural law article with regard to the determination of the market value of goods.
- Turkish value added tax (VAT) law article stating if the tax base for goods and services is unknown, the market prices based on the nature of the transactions will be the tax base.

- Turkish income tax law Article 41 includes partnerships and individuals subject to income within the scope of transfer pricing.
- Case law on an excessive number of decisions of Turkish tax courts after cases have been discussed at courts where tax inspectors challenged the transfer prices and eventually the disguised profit distribution of the taxpayer.
- Case law on tax rulings on the subject.

Legal cases

In recent years, the Turkish Ministry of Finance significantly increased its number of transfer pricing audits against companies, with a particular emphasis on the pharmaceutical, automotive and fast moving consumer goods sectors. In the course of these audits, the Ministry of Finance has focused on the following transfer pricing issues:

- Pricing of raw materials traded amongst related parties, with the government relying on industrial benchmarking studies that omit relevant risks and functions.
- Continual losses in previous years by companies that operate primarily through related companies abroad.
- Management fees and indirect cost allocations.
- Yearend adjustments.

It is expected that the companies will face different levels of tax audits under the subject of transfer pricing in the coming couple of years as the current rules seem to become a trendy subject to the tax inspectors.

Burden of proof

In Turkey, the burden of proof lies with the party making the claim under Article 3 of Turkish tax procedural law. Establishing proof includes an examination of the substance of the business event that gives rise to the transaction.

According to the requirements of the transfer pricing law, companies should be ready to provide evidence in order to explain why they chose to implement a specific transfer pricing method. Moreover, responsibility for safe-keeping of the workings/accounts and sheets for this issue rests with the taxpayers.

In the case of a tax audit, if the tax inspector claims the application of the transfer pricing method by the company is against the law, then the burden of proof will shift to the inspector. If a situation is claimed to be clearly lacking in economic, commercial and logical justification, the plaintiff is liable to prove his claim.

Tax audit procedures

The structure of tax audit institution has changed recently and the taxpayers are separated into two classes, which are large and small scope taxpayers. The taxpayers that are registered to the Large Taxpayers Tax Office are always monitored by the tax inspectors. Besides a new transfer pricing audit department established, that conducts only transfer pricing audits.

Revised assessments and the appeals procedure

Assessments are made by the tax inspectors at the end of the tax audit. There is no administrative appeals procedure, but a special reconciliation with the tax authority is possible. If parties cannot reconcile at the end of the reconciliation process, then the

Turkey

taxpayer is able to go to court. Likewise, the taxpayer can choose not to reconcile prior to the reconciliation process and go to court.

Additional tax and penalties

There are no specific transfer pricing penalties. The penalty provisions of the tax procedural law apply to those who do not submit the required documentation and/or where transactions are found to be inconsistent with the arm's-length principle. Briefly, if the profit that is distributed in a disguised manner through transfer pricing shall be deemed as dividends distributed, then necessary adjustments on taxes will be made at the hands of the party receiving the deemed dividends. In this respect, the taxes assessed in the name of the company distributing dividends in a disguised manner must be finalised and paid.

There is no specific tax loss penalty in Turkish tax legislation for transfer pricing adjustments. The general tax loss penalty provisions in the Turkish tax procedural law are applicable. The general tax loss penalty is equal to one fold of the unpaid tax. Additionally, there is a delay interest applied on a monthly basis (1.4% effective from 19 November 2010) for the period between the normal due date of the additional tax assessed and the date of assessment. Further, there is no specific reduction provision for transfer pricing-related tax loss penalty assessments; general rules in the Turkish tax procedures code are applicable. Taxpayers may appeal to the Ministry of Finance for a reduction in the tax loss penalty through settlement procedures with the tax authorities either before or after the imposition of the assessment.

Resources available to the tax authorities

During the tax audits, tax returns of the comparable companies may be used by the tax authority. Besides there is special audit unit under Turkish Revenue Administration to deal with transfer pricing issues. Both the local tax inspectors and the transfer pricing specialist tax auditors pose a high level of industry-specific knowledge, and they may use a variety of sources for benchmarking such as financial data published by listed companies as well as data from other taxpayers. The lack of statistical information for determining the profit margin of specific activities and the lack of local databases directly affect the accuracy of benchmarking studies.

Moreover, as mentioned in the *Documentation requirements section, above*, by using the annual form, inspectors may assess the amount of related party transactions in a year and initiate an investigation accordingly.

Use and availability of comparable information

As previously mentioned in the *Statutory rules section, above*, taxpayers may use both internal and external comparables. However, available local data in Turkey is limited because only publicly held companies are obliged to declare their financial data.

Turkish transfer pricing legislation neither provides a clear guidance on benchmarking studies nor prohibits the use of databases.

Therefore, it might be inferred that foreign comparables should be acceptable, provided that differences in geographic markets (if any) can be eliminated through appropriate adjustments and/or analyses. Besides, comparable company sets should be updated on an annual basis according to the most recently available data.

An important point to be considered for Turkish taxpayers regarding the use of 'publicly available comparable data' for the purpose of benchmarking (which is an OECD principle) is when determining transfer-pricing-related assessments Turkish tax auditors would highly tend to use their own 'secret comparables' to which only they have access, by virtue of their public authority. Turkish taxpayers are advised to be ready to challenge this approach, which is contrary to the relevant OECD principles.

Risk transactions or industries

Tax authorities use special software to determine the company they audit. This software includes all the financial information of the taxpayers and they are selected with the help of including but not limited to the following criteria: net sales amount, fluctuation in the profit margin, recent year losses, having loss in the current year, paying management or license fees to abroad related parties, having related party transactions with the companies that are based in low tax regime countries etc. Accordingly the number of transfer pricing audits has been increasing in recent years and it is expected to continue. Besides, tax authorities request the transfer pricing reports even if there is no transfer pricing audit. The numbers of the companies that are requested to submit their transfer pricing report to the tax authorities are increased dramatically in 2012. Lastly, in many cases transfer pricing audits may trigger VAT and customs related audits.

Limitation of double taxation and competent authority proceedings

Turkish tax treaties (currently with 74 jurisdictions) contain relevant mutual agreement procedure (MAP) articles. Countries that have signed a double tax treaty with Turkey may, in theory, pursue competent authority relief as a means of preventing double taxation arising from tax adjustment. However, in practice there are very rare cases where MAPs are initiated, meaning the MAP has not been tested by Turkish taxpayers as a means of preventing double taxation.

Advance pricing agreements

Methods to be used in determining the price regarding purchases or sales of goods or services with related parties may be agreed with the Ministry of Finance upon taxpayer's request. This approved method will be certain for a maximum period of three years within the terms and conditions of the agreement. If the administration identifies that the demand for the agreement interests more than one country and if there are already APAs considering the other country/countries, the administration may consider the possibility of a bilateral or multilateral agreement.

The APA process begins with the written application of the taxpayer after application fee (38,000 Turkish liras [TRY] for 2012) is paid. The taxpayer submits to the TRA the requested information and documents with the application. Information and documents submitted are subjected to a preliminary assessment by the TRA. If the information and documents do not allow the TRA to make a sufficient assessment, the TRA may request additional information and documents or meet with the taxpayer.

Following the completion of necessary data, an analysis is made regarding comparable transactions, assets used, applicable methods, agreement terms and other relevant aspects. As a result of the analysis, the TRA may accept the taxpayer's application as it is or approve it on condition that necessary modifications are made or reject it.

Turkey

Nine months prior to the end of the validity of the agreement, a taxpayer may apply for its renewal.

In view of practices throughout the world, it is observed that APA process changes according to complexity level and type (unilateral, bilateral or multilateral) of the agreement and completion of the process cannot be completed earlier than 18 to 24 months in average.

Anticipated developments in law and practice

Regarding the legislations no development has been anticipated in recent years; however regarding the practice, Turkish Tax Authorities has been focusing on transfer pricing applications of the taxpayers and this approach is expected to continue in the following years. In this respect, a new transfer pricing unit that consists of transfer pricing auditors has been established under the roof of ministry of Finance. In line with this development both the transfer pricing tax audits and the number of the companies that are asked to submit their transfer pricing reports increased dramatically in the last years.

Liaison with customs authorities

The customs rules in Turkey are not specifically coordinated with the transfer pricing rules. The customs authorities have their own legislative guidance for the treatment of inter-company transfers of imported/exported material. Additional TP regulations may create the need to incorporate customs practices into joint legislation. There have been joint efforts by customs and tax authorities to work on the transactions and to investigate import prices in specific industries. For example, reports have been written by a customs inspector that challenged import prices.

OECD issues

Turkey is a member country of the OECD and acknowledges the organisation's transfer pricing guidelines. On the other hand, as Turkey's transfer pricing regulations are new and at the development stage, they have yet to fully incorporate all the principles contained under the OECD Guidelines. The current transfer pricing law provides an impetus for the adoption of improved transfer pricing regulations in accordance with best international practice.

Thin capitalisation

The thin capitalisation issue is rearranged under Article 12 of the CITL. According to the Article, if the ratio of the borrowings from shareholders or from persons related to the shareholders exceeds three times the shareholder's equity of the borrower company at any time within the relevant year, the exceeding portion of the borrowing will be considered as thin capital.

The scope of the term 'related parties' consists of shareholders and the persons who are related with the shareholders that own 10% or more of the shares, voting rights or right to receive dividends of the company.

The shareholder's equity of the borrower company is defined as the total amount of the shareholder's equity of the corporation at the beginning of the fiscal year, or the difference between the assets and liabilities of the company. If the company has negative shareholder's equity at the beginning of the year, then any borrowings from related parties will be considered as thin capital.

If thin capitalisation exists, the interest paid or accrued, foreign exchange losses and other similar expenses calculated over the loans that are considered as thin capital are treated as non-deductible for CIT purposes. Moreover, the interest paid or accrued and similar payments on thin capital will be treated at the end of the relevant fiscal year as deemed dividends and will be subject to withholding tax.

Management services

Although in the past the law did not provide definitive legislation relating to management services, the new transfer pricing article takes the OECD Guidelines as a basis. Through these developments, management services may be subject to greater scrutiny under the transfer pricing regulations.

As per Turkish transfer pricing regulations, management services refer to one of the following:

- The services performed by the corporate headquarters to other related group companies.
- The services rendered by one group company to another.

These services are usually considered as services that ensure intra-group management, coordination and control functions. The costs of these services are undertaken by the parent company, a group company that is responsible for this purpose or another group company (group services centre).

From the perspective of Turkish transfer pricing-regulations, the following points have to be taken into consideration:

- Whether the service has been actually rendered.
- Whether the receiver company(s) needs the service.
- Whether the price of those services is at arm's length.

Because of the uncertainty of management services and their prices, management service fees are always an easy target for the tax audits to attack. The payments that fail the above-mentioned points may be criticised from a transfer pricing point of view and may be non-deductible for CIT purposes.

Helping you manage your transfer pricing risk

Today's transfer pricing rules are extremely complex. Multinational organisations are navigating operations in an ever expanding globalised world, and the stringent, diverse transfer pricing requirements they face are daunting. A combination of public debates on the ethics of tax planning, political and economic pressures, and increasingly well trained tax examiners will all contribute to a continuing increase in the number of transfer pricing disputes globally as more and more tax authorities attempt to enforce their transfer pricing rules aggressively.

International Transfer Pricing 2013/14, now in its 14th edition is an easy to use reference guide covering a range of transfer pricing issues in nearly 80 territories worldwide. The book offers practical advice on developing a coherent and robust transfer pricing policy that is responsive to today's climate of change, at your fingertips.

Written by local PwC transfer pricing specialists in each country, the book provides a global approach to transfer pricing issues and a summary of specific requirements of the key countries with transfer pricing rules. This book is up to date (unless otherwise stated) as of 15 September 2012.

Download an e-version of the book at www.pwc.com/internationaltp

ISBN 978-0-9575463-0-1



9 780957 546301 >