



TRANSFER PRICING



REPORT

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The New Transfer Pricing Regulations in Turkey

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The Turkish government in a Nov. 18 communiqué and Dec. 6 decree¹ created an advance pricing agreement program and set forth transfer pricing methods and documentation requirements. The new rules, similar to those in Organization for Economic Cooperation and Development guidelines:

- define “related party”;
- describe the available transfer pricing methods and their hierarchy;
- list the documents that different categories of taxpayers must prepare and submit to the tax administration; and
- set forth the conditions for entering into an APA.

Methods Available for Determining Arm’s-Length Price

Under Article 13 of the Corporate Tax Law, taxpayers in determining an arm’s-length price should use the most appropriate method according to characteristics of the transaction. Article 13 states that traditional and

unspecified methods can be used for determining the arm’s-length nature of transfer prices.

The general communiqué states that taxpayers should use the most appropriate method (best method) according to the nature of the transaction. If it is not possible to reach an arm’s-length price using traditional methods, taxpayers can use other methods, such as the profit split method or transactional net margin method (TNMM). If it is still not possible to reach an arm’s-length price using transactional profit methods, taxpayers can use unspecified methods.

Article 13 of the CTL and the other regulations define the traditional methods as the comparable uncontrolled, cost plus, and resale price methods. The profit split method, TNMM, and unspecified methods are defined as transactional profit methods.

Related Parties

The definition of “related party” under the CTL is broad. There is no minimum share requirement for a related party for transfer pricing. According to the CTL, a related party includes:

- a company’s own shareholders;
- individuals or companies that are related to the company or its shareholders;
- individuals or shareholders on which the company is directly or indirectly dependent or that are controlled by the company via management, auditing/supervision, or capital;
- spouses of shareholders of the company;
- lineal ancestors of shareholders; and
- other relatives (including third-degree).

For both income tax and corporate taxpayers, all transactions carried out with persons resident in the countries or the regions that have been announced as causing unfair tax competition by the Council of Minis-

¹ 16 Transfer Pricing Report 625, 629; 12/13/07.

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ters are treated as transactions carried out with related persons.

Documentation Requirements

The obligation to generate transfer pricing documentation is a statutory requirement. Under the new rules, all taxpayers must complete a form attached to the company's annual corporate tax return. On this form, taxpayers are required to present all the intra-group transactions that took place during the year and indicate the selected transfer pricing methods to test the arm's-length nature of the transactions.

In addition, until the end of the corporate tax return declaration date, taxpayers registered with the country's large taxpayer or "VIP" tax office must issue an annual report listing the international and domestic sales or purchases of goods or services with related parties during the calendar year. They also must be ready to present information and documents with the report. Companies registered with the VIP tax office are typically the largest companies determined by reference to turnover, payable taxes, and asset size.

Corporate taxpayers other than those registered with the VIP tax office are required to prepare this annual report listing only their international transactions with related parties.

Individual taxpayers and corporate taxpayers with no international related-party transactions are not required to prepare a yearly transfer pricing report but must prepare the transfer pricing documents stated on the general communiqué.

According to the communiqué, the following information must be included in the transfer pricing documentation:

- a description of the company's activities and organizational structure, a definition of the related parties (i.e., tax identification number, addresses, and phone number) and ownership information of these parties;
- all functions performed and risks taken;
- pricing lists for the year's products;
- details of the cost of goods;
- the amount and invoice information for all transactions with related and unrelated parties during the year;
- all agreements signed with related parties;
- financial statements of the related parties;
- intra-group pricing policies;
- intra-group accounting standards and policy differences if they exist;
- ownership of intangible assets;
- the transfer pricing method selected by the company (including the comparability analysis and selected comparables, whether external or internal);
- calculations and assumptions used to reach the arm's-length price; and
- calculations used to reach the arm's-length range, if applicable.

The law does not require a deadline for documentation, but the government decree and the general communiqué state that documentation should be prepared by the tax return submission date and should be submitted to the tax authority upon request. The decree and general communiqué state that if the transfer pricing documentation is prepared in a foreign language, Turkish translations also must be submitted to the tax authorities.

Advance Pricing Agreements

According to CTL Article 13, corporate taxpayers can apply to the Ministry of Finance for an APA. If a taxpayer and the Ministry of Finance reach an APA, the APA cannot be in use for more than three years. The government decree and the general communiqué on transfer pricing set forth details on APA procedures. According to the decree and the general communiqué, all corporate taxpayers are eligible to apply for an APA, but each APA covers only the taxpayers that signed that particular APA. Taxpayers can apply for unilateral, bilateral, or multilateral APAs.

A Feb. 4 proposal by the government would set the charge for a new APA at TRY 25,000 (US\$20,837) and for a renewal at TRY 20,000 (US\$16,641).

VIP taxpayers can apply to the tax administration beginning Jan. 1, 2008, and other corporate taxpayers can apply beginning Jan. 1, 2009. The method negotiated between the tax administration and the taxpayer becomes definite according to the conditions and period determined under the APA. The period for an APA will not exceed three years from the date the agreement was signed.

Pre-review of Application

APA applications are subject to a pre-review by the tax administration. The tax administration reviews the application to determine whether it is in line with the regulations and whether any necessary documents are missing. If the administration determines additional documents are necessary, the taxpayer must submit the missing documents. Completion of the pre-review does not mean that the tax administration has accepted the application.

Acceptance or Rejection of Application

After all necessary documents are submitted, the tax administration evaluates the comparables, assets used, adjustments, methods, and other requirements and conditions. After performing all analyses, the tax administration can accept the application for an APA with or without requiring any changes, or reject the application. If the application is accepted, the taxpayer and the tax administration sign the APA.

The period of the APA—which, as stated above, cannot exceed three years—is valid only after it is signed. During the covered period, it is possible for the taxpayers and the tax administration to have discussions about the execution of the APA.

The existence of an APA between the taxpayer and the tax administration does not mean that the taxpayer will not be subject to any tax scrutiny about the APA. Specifically, while the tax administration will not question the method determined in the APA, it may scrutinize the application of the method and the conditions stated in the APA.

Renewal of APA

To renew an existing APA, taxpayers must apply at least nine months before the last day of the APA. The taxpayer should submit the necessary information and documents stating that the transactions covered in the existing APA are in line with the arm's-length principle. If there is a change in the conditions and assumptions of the existing APA and if there is a need for amend-

ment after the renewal, the taxpayer is responsible for stating these issues at the time it applies to the tax administration for a renewal.

If, after evaluating the renewal application, the tax administration decides that the conditions and assumptions stated in the existing APA are still valid and that the determined method is in line with the arm's-length principle, it may extend the existing APA for one more period. If the tax administration decides that the conditions and assumptions have changed and that a new method needs to be determined, the taxpayer must apply for a new APA.

Revision of Existing APA

An existing APA between the tax administration and the taxpayer can be revised if:

- an assumption fundamental to the APA is unrealized;
- a material change in conditions occurs or the conditions stated in the APA are no longer valid;
- a change in laws and regulations, including double taxation treaties, occurs that will ultimately affect the APA; or
- in the case of bilateral or multilateral APAs, there is a revision, abolition, or cancellation of the arrangements by the administrations of other countries.

The taxpayer can apply to the administration for the revision of the APA. In the application, the taxpayer should submit the necessary information and documents, including the reason for the requested revision. The conditions for the revision of an APA can also be determined by the tax administration. If the parties agree on the revision of an APA, new conditions will be effective from the date of the revision until the end of the existing arrangement period. If the taxpayer does not accept the revision of the APA, the tax administration may cancel the APA.

Cancellation of APA

The tax administration has the authority to cancel an existing APA. Under such circumstances, the provisions of the APA will not be effective from the signing date, leaving the taxpayer vulnerable to scrutiny from that

date. The tax administration may cancel an existing APA if:

- the taxpayer does not obey the conditions negotiated in the APA; or
- the information and documents provided by the taxpayer during the application and subsequent periods (including annual reports) are determined to be missing, wrong or misleading.

In addition, if the annual report, which must be sent to the tax administration every year before the corporate tax return declaration date, is not presented on time, the existing arrangement can be canceled from the start of the related fiscal year in which the report is prepared.

Penalties

No special penalty applies for violating the transfer pricing regulations. General tax penalties are effective when the transfer prices are not arm's length and if there is a tax exposure. Turkish Tax Procedural Code articles providing for penalties will be applied to taxpayers observed to have engaged in non-arm's-length transactions, which taxpayers will be deemed to have distributed disguised profit via transfer pricing. A procedural penalty will apply if documentation requirements are not fulfilled.

Conclusion

Many taxpayers did not take any action regarding the new transfer pricing requirements until they were finalized. While calendar-year taxpayers must complete their transfer pricing documentation by April 25, many taxpayers still do not know how to comply with the new regulations.

Although the communiqué and the government decree were published near the end of 2007, the new law is effective from Jan. 1 of that year. Because transactions with related parties are always a primary focus of tax inspectors, with tax auditors even now examining related-party transactions for 2006, it is vitally important that companies familiarize themselves with these new provisions.