

GUIDELINE

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Turkish Transfer Pricing Documentation Guideline

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TURKISH TRANSFER PRICING DOCUMENTATION GUIDELINE

1. Legal Arrangements for Transfer Pricing Documentation

Transfer pricing legislation was introduced by Article 13 of the new Corporate Income Tax Law 5520 of 21 June 2006 and is in force from January 1 2007. Definitions in OECD Guidelines were taken into consideration in Article 7. In parallel with the transfer pricing rules introduced into the Turkish tax system by the new Corporate Income Tax Law, a related provision has been added to Article 41 of Personal Income Tax Law 193.

Article 13 (3) of the Corporate Income Tax Law states that a company must keep records, charts and other documentation relating to determination of the arm's-length principle. This must include details of all calculations and proceedings related to the method used for related-party transactions and the implementation of the method.

Moreover, Article 13 (7) of the Corporate Income Tax Law provides that the procedures governing transfer pricing are to be determined by the Council of Ministers. The Council of Ministers has specified these procedures in Decree 2007/12888. The decree, like the transfer pricing guidelines, sets forth rules with regard to transfer pricing, as well as transfer pricing documentation.

Furthermore, the Ministry of Finance prepared and notified a Communiqué on the Hidden Distribution of Profit to ensure that taxpayers better understand transfer pricing principles including documentation rules and how uniform application is achieved.

2. Level of Documentation

All related parties that are taxpayers in Turkey must prepare transfer pricing documentation that can be used as a basis for assessing the transfer prices, to determine whether prices and terms of inter-company transactions are at arm's length or not. However, personal income taxpayers, if a part of transaction, are obliged to prepare the necessary documents for related-party transactions in case the tax authorities require them. So the Decree and Communiqué on the Distribution of Hidden Profit by means of Transfer Pricing determine the documentation requirements.

Information and documents which must be compiled for related-party transactions are:

Summary information about description of the activities, form of the organisation (headquarter and branches), shareholders, form of capital, sector, economic, legal background of the taxpayer and description of the related parties (for example, tax ID number, address and telephone numbers) and information about ownership relations between these parties;

- ◆ All information related to the functions, risks assumed and assets used;
- ◆ The price list in the year transaction occurred;
- ◆ The cost of production in the year transaction occurred,

- ◆ Information about the volumes of controlled and uncontrolled transactions in the fiscal period which involves transaction date and invoices, bank slips and similar documents;
- ◆ The copies of agreements issued between related parties at the fiscal period of transaction;
- ◆ Summaries of financial statements of related parties,
- ◆ The intercompany pricing policy applied to transactions between related parties;
- ◆ If the related parties use different accounting standards and methods, the information related to these standards and methods;
- ◆ The information related to intangible property ownership and payments of intangible rights;
- ◆ Information and documents (internal and/or external benchmarks, comparability analysis) related to choice and application of transfer pricing method used;
- ◆ Detailed information related to calculation and assumptions to determine arms' length price or profit margin;
- ◆ If arm's-length range is determined, the method used in the determination of that range; and
- ◆ Other documents that is required to determine the arm's-length price.

Information and documents, except by VIP (the biggest 500 corporate taxpayers determined according to their revenue, gross profit, extent of asset and the number of employees) tax office taxpayers, are not submitted, as a matter of course, with a company's annual corporate tax return but should be ready for tax purposes until April 25, when corporate tax returns are submitted, if they are required by the tax authorities.

In addition, the revenue administration may ask for additional information and documentation from the taxpayer, if necessary. If the related information and documents are in a foreign language, they must be translated into Turkish.

3. Annual Documentation

VIP tax office taxpayers have to prepare an annual transfer pricing report that includes the listed information and documents related to their domestic and cross-border transactions with related parties in a fiscal year until the end of the corporate tax declaration period and present it to the Tax Office.

The same documents are separately submitted to the tax scrutiny authorities by taxpayers if requested. Corporate taxpayers, other than those registered with the VIP tax office, only need to prepare an annual report related to their cross-border transactions with related parties.

As things stand, corporate taxpayers other than those registered with the VIP tax office are not required to prepare a transfer pricing report for their domestic related-party transactions and personal income taxpayers are not required to prepare a transfer pricing report for both their domestic and international related-party transactions. However they must do so if the tax authorities ask them to.

4. Documentation for Advance Pricing Agreements

Article 13 of Corporate Income Tax Law states, for tax purposes, that the transfer prices applied in the purchase or sale of goods or services between related parties, as well as methods to be used to compute such prices, may be specified in an advance pricing agreement (APA) with the Ministry of Finance. The method determined by this means will be valid for a maximum of three years if the terms and conditions specified in the APA remain applicable. The main objective of an APA for Turkish tax legislation is to prevent likely tax disputes related to transfer pricing which taxpayers face during the purchase or sale of goods or services with related parties.

All of a corporate taxpayer's transactions are not included in the scope of the APA. VIP tax-office taxpayers, who are subject to the jurisdiction of the tax administration's large corporation tax office, can apply to the tax

administration from January 1 2008 for APA guidance; other corporate taxpayers can apply to the tax administration from January 1 2009 with respect to the appropriate method to be determined for controlled cross-border transactions.

On the other hand, beginning from January 1 2009, it will be possible to request a bilateral or multilateral APA for transactions between corporate taxpayers operating in Turkey's free trade zones and related parties outside the zones.

If the Turkish tax authorities conclude, having assessed the taxpayer's request for an APA, that related-party transactions have links with other jurisdictions, it can decide to negotiate a bilateral or multilateral APA with the competent authority (ies) if a tax treaty exists between Turkey and its partner state(s). Turkish Revenue Administration will levy a non-refundable user charge for each accepted APA of TL25,000 [\$21,000] or TL15,000 for the renewal of an APA.

5. Level of Documentation for an APA

The basic information and documents that taxpayers who request an APA should present to the tax administration are:

Written application (the requested period of arrangement; names, Republic of Turkey ID numbers, addresses and telephone numbers of taxpayers or their representatives who will be involve in the arrangement process, taxpayers' line of business, structure of organisation (headquarter and branches), shareholders, capital structure, sector, summaries of economic and legal background, definitions of related parties and ownership relations of related parties should be stated in written application);

- ◆ All information related to the functions, risks of corporation and assets that are used;
- ◆ Documents and reasons related to critical assumptions (suggested transfer pricing method and explanations, analysis and other works based on the choice and application of this method);

- ◆ The information related to intangible property ownership and payments of royalty or intangible rights;
- ◆ If the related parties use different accounting standards and methods, the information related to these standards and methods;
- ◆ The price list at the fiscal period of the application date;
- ◆ The cost of production at the fiscal period of the application date;
- ◆ The intercompany pricing policy applied to transactions between related parties;
- ◆ The information about the volumes of controlled and uncontrolled transactions at the fiscal period which involves transaction date and invoices, bank slips and similar documents;
- ◆ Related parties' financial statements from the previous three years, copies of income or corporate tax returns and copies of agreements about foreign transactions;
- ◆ The financial data and documents of the previous three years supporting the suggested transfer pricing method;
- ◆ If there are two or more comparable transactions, the arm's-length range and the method used in the determination of that range; and
- ◆ Other documents required to determine the arm's length price.

The administration may ask for additional information and documentation from the taxpayer if it is considered necessary. If the related information and documents used to request an APA are written in a foreign language, they must be translated into Turkish. The original documents written in other languages must also be submitted, if required. .

6. Tax Return Disclosures

Taxpayers (except personal income taxpayers) undertaking a purchase or sale of goods or services with related parties must fulfil and submit their tax returns electronically by enclosing The Form on Transfer Pricing, Controlled Foreign Company and Thin Capitalization by April 25 after the (end of the) tax year. In this form, the tax authority sees a short summary of the related-party

transactions. There is no exception for corporate taxpayers regarding submission of the related form. Its main function is that Turkish tax authorities uses it to help them decide to hold an inquiry. If a company doesn't submit it or submit it improperly, the tax authorities could launch a transfer pricing, controlled foreign company or thin capitalisation inquiry.

On the other hand, during APA, the annual report allows the tax authorities to decide whether the taxpayer is following the conditions of agreement and if these conditions are still valid or not. A taxpayer that has signed an official APA with the tax authority has until the April 25 after the end of the financial year, the last day to file corporate tax returns, to submit the advance pricing agreement report. However, the taxpayers, with an APA don't need to prepare a separate annual transfer pricing report for transactions included in the context of APA.

7. Record Retention

There is no special determination in Corporate Income Tax Law for the retention of records related to transfer pricing. All records required are to be kept according to the terms of Turkish Tax Procedure Code. For tax purposes, as others, those records must be kept for a period of five years from the end of the chargeable period to which they relate.

8. Penalties for Lack of Compliance with Documentation Requirements

There are no special kinds of penalty for transfer pricing issues. However, personal income taxpayers and corporate taxpayers who have purchased from or sold goods or services to related parties at a price not in line with the arm's length principle either entirely or partly, are punished by the penalties set out in the Turkish Procedure Code. Also, those who don't submit documents to

the tax authority in compliance with these obligations, are punished separately by the same penalties in the Turkish Procedure Code.