GUIDELINE ON TURKISH TRANSFER PRICING RULES

CENTRUMCONSULTING

International Consulting and Transfer Pricing Services

Reference to the Arm's Length Principle

The Arm's Length Principle in Turkish legislation means that prices should be the same as they would have been, had the parties to the transaction not been related to each other. The arm's length price named also as an open market price is the price which is created by arm's length parties under the conditions occurred during transaction. This price is the best amount that is set objectively without any effect by sides during the transaction.

Reference to the OECD Transfer Pricing Guidelines

None

Definition of Related Parties

In the implementation of Corporate Income Tax Law, the term named "real person" taking place in the Article 13 means the individuals taxable and partnership companies or ordinary partnerships; the term named "corporate" means equity companies, cooperatives, quasi- public companies, associations and foundation and joint ventures.

Related Parties of the Corporate Taxpayers

According to Article 13 of Corporate Income Tax Law, related parties for the corporate taxpayers are:

- Company's own shareholders holding at least 10% of company's equities,
- Individuals and entities associated with the shareholders,
- Individuals and entities attached to the company directly or indirectly in the management, supervision or capital,
- Individuals and entities under the control of the company directly or indirectly in the management, supervision or capital,
- The shareholder's spouse and any relatives including lineage with third degree relationship by blood or marriage

Cross border transactions will be regarded as related party transactions if performed between other parties at foreign jurisdictions or regions, which are announced by the Council of Ministers that provide harmful tax regimes by looking at whether taxation on profit in the foreign jurisdiction is at the same level and capacity with Turkish taxation.

Related Parties for the Personal Income Tax Payers

According to Article 41 of Personal Income Tax Law related parties considered as related parties for the individual income tax payers are:

- The spouse of business' owner and any relatives of the business' owner including lineage with third degree relationship by blood or marriage,
- Companies in which business' owner is a shareholder directly or indirectly in the management, supervision or capital,
- Shareholders of companies in which business' owner is a shareholder directly or indirectly in the management, supervision or capital,
- Other companies controlled in management, supervision or capital by business' owner.

Transfer Pricing Methods

Companies determine the arm's length transfer prices to be applied for related party transactions by using the best suitable of the below stated methods taking into account the true nature of transactions. Article 13 of Corporate Income Tax Law prefers firstly to be used one of the traditional methods, which are Comparable Uncontrolled Price method, Resale Price Method, or Cost Plus Method.

If there is no possibility to arrive for the arm's length price by using one of the Traditional Methods, the taxpayer can use other methods as the best method according to the conditions and circumstances of transaction. In such a case, Transactional Profit Methods, which are Profit Split Method and Transactional Net Margin Method, could be used.

However, if transactional profit methods don't even help to achieve to the arm's length price, the taxpayer could use a method determined by himself. Operating system of this method determined by the taxpayer must also be compatible with the arm's length principle. Legal determinations of transfer pricing method in Turkish legislation are as follows.

Comparable uncontrolled price method: The arm's length price is determined by comparing the company's transfer price to the (market) price applied in comparable purchase and sale of goods or services between unrelated individuals or entities.

Cost plus method: The arm's length price is determined by applying an appropriate gross profit mark up on costs incurred in supplying of goods or services.

Resale price method: The arm's length price is determined by reducing an appropriate gross profit margin from the resale price applied when goods or services in question are resold to unrelated individuals or entities.

Transactional Net Profit Margin Method: The transactional net profit margin method relies on the examination of the net profit margin in a controlled transaction identified by the taxpayer relative to an appropriate base such as costs, sales or assets. Although the TNMM method is in some ways similar to the application of cost plus and resale price method, the difference of TNMM from these other methods is that the other two methods require calculation of the gross profit margin, whereas this method requires the calculation of net profit margin.

Profit Split Method: It is based on the allocation of total operating profit or loss attributable to one or more controlled transactions of related parties at the arm's length rates among the related parties by reference to the functions performed and risks undertaken. According to General Communiqué, this method should be used in cases when the traditional transaction methods are not feasible and particularly when there are no comparable transactions and the transactions between the related parties are indispensable from one to another.

Other Methods: When none of the defined methods in the Article 13 are conclusive in determining the arm's length price, other methods defined by the company as most appropriate for true nature of the transactions can be applied.

Transfer Pricing Documentation Requirements

Company records, charts and other documentation relating to determination of the arm's length principle must be kept within the company as documentary evidence. Consequently, documentation of all calculating and proceeding, which are related with the method used and implementation of method, must be detailed.

Level of Documentation

All related parties 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. Turkish Cabinet Decision and Communiqué on the Distribution of Hidden Profit via Transfer Pricing determine the documentation requirements which are:

- Description of business, organization chart (Headquarter, and branches), shareholders, capital structure, the sector operated, summarized information on the company's legal backround, description of related parties (tax identification numbers, addresses, phone numbers and so forth) and information about ownership relations among the related parties,
- Description of the functions performed, the assets used or contributed and the risks assumed, in respect of the transaction by the parties,
- Product price lists in the concerning year of transaction,
- Cost of production in the concerning year of transaction,
- The amount of transactions made with related parties and their bills, statements of account and smilar documets in the concerning year of transaction,
- The copies of all agreements accomplished among the related parties in the concerning year of transaction,
- Brief financial statements of the related parties
- Intracompany pricing policies applied to the transactions of related parties,
- Data, if the related parties use different accounting standarts and/or methods
- Data on the ownership of intangibles and the price of intangible gained or paid,
- Description of the transfer pricing method selected, an explanation of why that method was selected and documents and data for the implementation of concerned method (internal and/or external comparables, comparability analysis)
- Detailed information on the assumptions and computations used to determine the arm's lentgh price and profit margin
- The method to be used for finding that range if a certain range of transfer prices is determined,
- Other nessesary documents to determine the arm's lentgh price.

If Revenue Administration or tax auditor consider something nessesary for the documentation of transfer pricing, it may asks for additional information and/or document from the taxpayers.

Language for Documentation

By tax administration, it is expected that documentation is in Turkish. If documents are written in other languages, they have to be submitted together with original copies by being translated into Turkish.

Tax Return Disclosures

The taxpayers (except individual taxpayers) having purchase or sale of goods or services with related parties must fulfill and submit their tax returns electronically by enclosing "The Form on Transfer Pricing, Controlled Foreign Company and Thin Capitalization" until April 25 after tax year.

On the other hand, in the period of Advance Pricing Agreement, Tax authority controls by the annual report whether the taxpayer follows the conditions of agreement and these conditions are still valid or not. The report on Advance Pricing Agreement must submit together with corporate tax return every year in all period of agreement until April 25 when is the last day for tax return.

Record Keeping

There is no special determination in corporate tax code for the records related with transfer pricing. For tax purposes, as others, documentation must be kept for a period of 5 years from the end of the chargeable period to which it relates.

Specific Transfer Pricing Audit Procedures and / or Specific Transfer Pricing Penalties.

Tax authority will review transfer pricing as a part of a taxpayer's tax audit or risk review. In general, any multinational with international related party dealings and incurring losses or low profits can expect to be scrutinized by the Turkish tax authorities.

There is no special kind of penalty for Transfer pricing issues. However, business' owners or corporates having purchase or sale of goods or services against the arm's length price entirely or partly with related parties are punished by the penalties taking place in the Turkish Procedure Code. Also, if those who have to submit the documents to the tax authority don't comply with these obligations, they are punished by the same penalties according to Turkish Procedure Code.

Relevant Regulations on Advance Pricing Arrangements

In the Article 13 of the Corporate Tax Code, it is stated that the substitutes or transfer prices applied for purchase or sale of goods or services between related parties as well as methods to be used for computation of such prices could be determined upon agreement with the Ministry of Finance (Revenue Administration) and the method determined by this means will be valid for duration of three years given that the terms and conditions fixed by such an agreement do not change.

Accordingly, it is possible to apply to the tax authority with necessary documents for the tax payers who have hesitancy on which transfer pricing method should be used in their transactions for a certain time. Only corporate taxpayers are in the scope of advance pricing agreements. In this frame, the taxpayers registered to the Large Taxpayer's Tax Office in Istanbul and beginning from January 1 of 2009, all corporate taxpayers without any exceptions and limit could request an APA from Turkish Tax Authority, named as Revenue Administration, for only the cross-border transactions with their non-resident entities or related parties to determine the method to be used. [1]

Furthermore, the taxpayer who applies for the agreement could ask for a bilateral or multilateral advance pricing agreement. Where tax authority finds out that the subject concerns more than one country after assessing the request for bilateral or multilateral advance pricing agreement, it decides provided that there is a tax treaty with concerned country.

[1] It is also possible to request an APA in the subject of transfer pricing for the transactions occurred among the corporate taxpayers operating in the free trade zones in Turkey and other corporate taxpayers operating outside of the free trade zone in the scope of related parties.

Renewal of an APA

Taxpayers can demand for renewal of an APA. In such a case, Taxpayer has to file a request for the renewal of previous APA, no later than nine months before the current APA expires. Taxpayer should submit appropriate updated supporting documentation, similar to that required for your initial APA request and submission, with the renewal request.

Revenue Administration may renew an APA under similar terms and conditions on request, when both taxpayer and itself are satisfied that:

- Transfer pricing method in previous APA continues to be appropriate
- There have been no material changes in the facts and circumstances underlying the APA and the critical assumptions remain valid and relevant; and
- Taxpayer has complied with the terms and conditions of the previous APA.

Revising an APA

An APA which was signed officially between Revenue Administration and taxpayer may be revised if it is established that:

- There has been a failure to meet a critical assumption,
- There has been a change in law, including a treaty provision, that modifies the tax treatment of any matter covered by APA,
- There has been a material change in circumstances,
- The participating foreign tax administration's APA is not consistent with concerned APA or has been revised, cancelled, or revoked.

Canceling an APA

In the form hereinafter set forth, tax authority could cancel an APA unilaterally from the opening day of the first APA year and it may accept as if the agreement were never made by starting a tax audit on taxpayer if:

- Taxpayer or his non-resident entities failed to comply with any material term or condition of concerned APA
- Taxpayer submitted the documents or information misleading, deficient or wrong, both in the APA request or following stages (including annual APA report).

Other Relevant Information on Transfer Pricing

All full and limited liable individuals and corporations in Turkey are in the scope of Transfer pricing regulations. Purchase or sale of goods or services made externally or internally with related parties are accepted in this scope. There is no difference between cross-border transaction and domestic transactions while transfer pricing regulations are implemented and no special provision or exception for small or middle sized enterprises.