

TURKEY

INTRA-GROUP SERVICE CHARGES

Formal transfer pricing (TP) rules were introduced in Turkey effective from 1 January 2007.

The local TP rules, under Article 13 of the Corporate Income Tax Law, generally follow the arm's-length principle, established by the OECD Transfer Pricing Guidelines (Guidelines) and are applicable to all financial, economic and commercial transactions and employment relations between associated parties. Details on the application of Article 13 are set out in a Communiqué on Transfer Pricing (the TP Communiqué).

Turkish local transfer pricing legislation also uses the Guidelines as a basis with regard to Intra-Group Services. In parallel with the Guidelines, the TP Communiqué includes a separate section (Section-11) for Intra-group Services. However, there are certain deviations from the Guidelines, as summarised below. According to this Section, Intra-group services are:

- Services performed by the corporate headquarters to other related group companies; and/or
- Services that are rendered by one Group Company to other(s).

Conditions

The following conditions must be satisfied in order to determine that the Intra-Group service pricing is in accordance with the transfer pricing rules:

- The service must in fact be rendered;
- The intra-group charge for such services must be in accordance with the arm's length principle; and
- The recipient company(s) must need the services.

The former two conditions were directly derived from the Guidelines and tax rulings; the Turkish Tax Administration follows the interpretation of the Guidelines with regard to these conditions (*i.e. the determination of whether intra-group services have been rendered depends on whether the activity provides a respective group member with economic or commercial value to enhance its commercial position*).

The last condition, stated in the TP Communiqué, may be regarded as the intention of the Turkish Tax Administration to highlight the importance of the "shareholder activities" issue, as evaluated in Section VII/B1/ 7.9.-7.18 of the Guidelines.

However, in practice this condition may raise more issues than shareholder activities. For example, although the Guidelines deal with this issue as a component of "determining whether intra-group services have been rendered", by demonstrating the scope of shareholder activities, the above-mentioned final condition requires taxpayers to prove that they need to receive the intra-group service.

In several tax rulings, it is stated that deduction of intra-group charges (especially incurred within the scope of cost allocation agreements) would not be allowed where the service agreements and relevant documentation are insufficient to prove that the recipient companies need to receive the services.

Applicable TP Methods

According to TP Communiqué Section-11/4, Comparable Uncontrolled Price (CUP) and Cost Plus methods supersede other methods (*the Resale Price Method, Transactional Net Margin Method and Transactional Profit Split Method*) regarding intra-group services.

Taxpayers may apply transfer pricing methods other than CUP and Cost Plus methods, unless application of these two methods is possible.

Non-compliance with local TP rules

Intra-group charges which fail to satisfy the above-mentioned conditions are to be challenged under transfer pricing rules, and accordingly may be regarded as deemed profits. Such deemed profits are regarded as tax non-deductible expenses from a corporate income tax point of view.

Since these amounts are deemed as dividends, they will be subject to withholding tax, unless the other party is a resident corporate income taxpayer. Pursuant to the local legislation, the withholding tax rate on dividend distributions is 15%.

Furthermore, input VAT on service charges in excess of arm's length value cannot be deducted or recovered.

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