

# Significant Transfer Pricing Disputes - I Adecco A/S-Decision of Supreme Court of Denmark

Governments, which are encountering with the pressure to balance public expenditures, deteriorating after Covid-19 outbreak, are expected to increase the frequency of tax inspections.

The importance of Transfer Pricing (TP) increases in the gradually globalizing world. In the last 30 years, efforts made by the Organization for Economic Cooperation and Development (OECD) has formed a global understanding in terms of TP. Accordingly, a TP dispute experienced in a jurisdiction is also highly significant for all jurisdictions, including Turkey, which regulate their legislations in line with the principles of OECD.

## Tax inspection and assessment

Adecco A/S, which is a Danish affiliate of a multinational enterprise group, whose headquarters are located in Switzerland, pays royalties to holding company of the group in Switzerland according to a license agreement concluded. During tax the inspection, Danish Tax Authorities claimed that royalty payments did not meet the requirements determined according to the domestic laws of Denmark regarding deduction of expenses.

In addition, tax authority claimed that the royalty amount in question is not in line with arm's length principle even though it is deductible and thus the case had been brought to the court by Adecco A/S.

## Litigation process and judgment of court of first instance

Court of First Instance has primarily stated that a payment for royalties can be made and such royalty payable by Adecco A/S can be deducted from tax base in theory, however, adjudged that an independent entity would not pay such high level of royalty even though it made loss for a long period of time.

In summary, court of first instance has judged in favor of Tax Administration through rejecting bill of review of Adecco A/S with respect to following reasons:

- The entity in question made loss for long period of time
- The competition in the related market is associated with the price instead of the brand
- The entity is currently incurring high levels of marketing expenses
- The entity could not prove in a reasonable manner the benefit gained from utilization of such brand and could not respond to requests of information and document of the Tax Administrations during inspection process as well as their inquiries
- Insufficient level of transfer pricing documentation.

## **Judgment of supreme court**

Adecco A/S has brought the lawsuit to Supreme Court (Højesteret), which is equivalent of Council of State in Turkey, when an unfavorable verdict was given. Supreme Court primarily stated in its review that royalties paid in terms of utilization of brands, inclusion in a certain network or communicating with clients based on reference are deductible expenses regardless of the entity making loss.

In this phase, Supreme Court has stated that the case is required to be inspected in scope of transfer pricing legislation. In this review, it is important that the Tax Administration has the burden of proof.

Supreme Court has the objection to tax administration in terms of declaration of transfer pricing reports null and void and making an assessment through determining a rate/price itself. Supreme Court also stated that such review could be possible if no report is issued by the taxpayer or in case the report is almost not ready, so weak and almost null and void.

Afterwards, the court examined the comparables in transfer pricing report of the entity and as a consequence, it concluded that 2% of royalty price applied cannot be reviewed as in contradiction to comparable rates applied.

As a result, this lawsuit is highly valuable in terms of demonstrating the difference between reviewing of a case during inspections related to payments made with related parties and recognized as expense in scope of deductible expenses and transfer pricing and rejection of transfer pricing documentation by tax administrations and making arbitrary assessment.

*Explanations in this article reflect the writer's personal view on the matter. EY and/or Kuzey YMM ve Bağımsız Denetim A.Ş. disclaim any responsibility in respect of the information and explanations in the article. Please be advised to first receive professional assistance from the related experts before initiating an application regarding a specific matter, since the legislation is changed frequently and is open to different interpretations.*