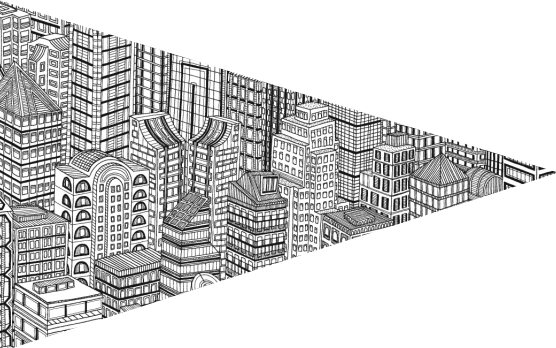


# International Tax Alert



## Turkey increases inspections regarding intra-group services

### Executive summary

There has been an increase in the number of inspections carried out by the Turkish tax authority regarding intra-group services such as management fees, cost allocations, etc.

During these inspections, taxpayers are generally criticized on the grounds that the professional services provided from group companies are routine and passive in nature and that the main aim of these services is to create and maintain a brand identity.

The tax inspectors tend to claim that since the services are based on knowledge and commercial experience rather than independent professional activity, the benefits received from intra-group professional services are similar to utilizing an intangible right; therefore, the payments for these services must be treated as a royalty and be subject to corporate tax withholding.

### Detailed discussion

#### The practice

Under the article 30 of Turkish corporate tax code, payments made by Turkish taxpayers to non-resident companies for the purchase, transfer and assignment of intangible rights, such as copyrights, trademarks, patents and trade names, are subject to withholding tax at the rate of 20%. Payments for professional services are also subject to 20% withholding tax. However, as double taxation treaties are superior to local tax legislation, the relevant double taxation treaty should be taken into account before applying withholding tax for both types of payments.

Turkey has concluded double taxation treaties with more than 70 countries and in these treaties the term royalties is generally defined as a consideration for the use of, or the right to use any copyright of literary, artistic or scientific work including cinematograph films, any patent, trade mark, design or model, plan, secret formula or process concerning industrial, commercial or scientific experience. In most of these treaties, royalty income earned by non-resident companies can be taxed in Turkey at the rate of 10% through withholding.

Turkey's double taxation treaties also cover professional services; however, some certain requirements should be met for a professional service income to be taxable in Turkey like the 183-day requirement present in the OECD Model Double Tax Convention.

Companies apply withholding tax for intangible right payments at the rates determined by the relevant double taxation treaty. However, for professional services, withholding tax is rarely applied in practice since it is hard to meet the requirements described by the double tax treaties.

### **Inspection and criticism**

Under article 65 of the Income Tax Law the nature of professional services are defined as follows:

Income arising from activities of professional services are professional service income. A professional service activity is the conduct,

without being subject to an employer, and under one's own personal responsibility and in one's own name and on one's own behalf, of work which is not of a commercial nature and which is not so much dependent on capital as on personal effort, on practical or professional knowledge, or on one's specialization.

According to the OECD Model Double Taxation Treaty, the term professional services includes especially independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants, and other activities requiring specific professional skill.

In recent inspections, tax inspectors have argued that professional services received from group companies under the name of management services or intra-group services, etc., are routine and passive services which aim to secure a certain level of quality and improve brand recognition.

They claim that the term professional services as explained in the double taxation treaties and Turkish income tax code includes especially independently handled activities of scientific, literary, artistic and educational value that require special professional knowledge and skills such as those of doctors, lawyers, engineers, architects, dentists, accountants, etc.

In the tax assessment reports, it is argued that activities, such as sales and marketing consultancy, cost analysis, financial management advisory, business development consultancy or quality management, are performed by a group company to protect a brand or in a more general sense to create a "value" for the benefit of the whole group. Therefore, these sorts of services which do not satisfy professional services as defined in the Turkish income tax code and double taxation treaties should be treated as a part of brand royalty.

Other common criticisms of tax inspectors are:

- ▶ Payments for professional services are determined as a certain rate of the turnover at a certain period as in the royalty payment method.
- ▶ The services are not specifically performed for the Turkish entity.
- ▶ The services received and the payments made cannot be substantiated in detail.
- ▶ Lack of adequate evidence regarding the actual delivery of the services.
- ▶ The service agreements include utilization of intangible rights and no discrimination between services and intangible rights can be performed.

In a recent court case (Resolution no E:2006/219 and K:2006/261), such services in which the non-resident company has wide knowledge and experience regarding the commercial, technical, industrial

and administrative management techniques and these specific knowledge and experience are benefitted as a whole, are defined as an intangible right. Therefore, the amounts paid for professional services are actually incurred to benefit from industrial, commercial and scientific experiences the multinational group owns.

Similarly, in tax assessment reports it is argued that services granted by a non-resident company under a technical assistance service agreement cannot be differentiated from a brand royalty since the services aim to secure a certain level of standardization and quality throughout the group. The amount paid as a technical service fee is actually compensation for the right to use a group's brands and perception in the market. Although each court decision is unique and considered in respect to different facts and circumstances, the above

mentioned cases and several other tax assessment reports increase concerns over similar decisions in the future.

Professional services, royalties and cost sharing transactions have always been one of the favorite areas tax inspectors investigate and we expect tax audits regarding this sort of transactions to continue at an increased pace.

According to Turkish transfer pricing legislation, with respect to intra-group services, the following issues should be determined;

1. Whether or not the service is actually rendered
2. Whether or not the company/ companies require the related service
3. Whether or not the service cost is in line with the arm's length principle, in the case that the service is rendered

Therefore, to decrease the risk of criticism regarding withholding tax and transfer pricing issues, it is important that the content of intra-group services, royalties and cost sharing transactions be based on agreements which contain details regarding the content of the transaction. Moreover, reports prepared by independent audit companies or other independent institutions which determine and analyze cost pools, calculation tables and details regarding the content of the services, as well as other studies that aim to determine the arm's length character of the profit margin applied in these transactions should be obtained and submitted to the tax authority when necessary.

For additional information with respect to this alert, please contact the following:

**Kuzey Yeminli Mali Müşavirlik A.Ş., İstanbul**

- |                     |                  |                          |
|---------------------|------------------|--------------------------|
| ▶ A. Feridun Güngör | +90 212 368 5421 | feridun.gungor@tr.ey.com |
| ▶ Akif Tunç         | +90 212 368 5723 | akif.tunc@tr.ey.com      |

## International Tax Services

- ▶ **Global ITS**, Jim Tobin, *New York*
- ▶ **Americas**, Jeffrey Michalak, *Detroit*
- ▶ **Asia Pacific**, Alice Chan, *Shanghai*
- ▶ **Europe, Middle East, India and Africa**, Alex Postma, *London*
- ▶ **Japan**, Kai Hielscher, *Tokyo*
- ▶ **Latin America**, Alberto Lopez, *New York*

---

▶ <b>Argentina</b>	Carlos Casanovas	<i>Buenos Aires</i>
▶ <b>Australia</b>	Daryn Moore	<i>Sydney</i>
▶ <b>Austria</b>	Roland Rief	<i>Vienna</i>
▶ <b>Belgium</b>	Herwig Joosten	<i>Brussels</i>
▶ <b>Brazil</b>	Gil Mendes	<i>Sao Paulo</i>
▶ <b>Canada</b>	George Guedikian	<i>Toronto</i>
▶ <b>Central America</b>	Rafael Sayagues	<i>San José</i>
▶ <b>Chile</b>	Osiel Gonzalez	<i>Santiago</i>
▶ <b>China</b>	Becky Lai	<i>Beijing</i>
▶ <b>Colombia</b>	Ximena Zuluaga	<i>Bogota</i>
▶ <b>Czech Republic</b>	Libor Frýzek	<i>Prague</i>
▶ <b>Denmark</b>	Niels Josephsen	<i>Soborg</i>
▶ <b>Finland</b>	Katri Nygård	<i>Helsinki</i>
▶ <b>France</b>	Claire Acard	<i>Paris</i>
	Régis Houriez	<i>Paris</i>
▶ <b>Germany</b>	Stefan Koehler	<i>Frankfurt</i>
▶ <b>Hong Kong</b>	Chris Finnerty	<i>Hong Kong</i>
▶ <b>Hungary</b>	Botond Rencz	<i>Budapest</i>
	Balazs Szolgyemy	<i>Budapest</i>
▶ <b>India</b>	Vijay Iyer	<i>Bangalore</i>
▶ <b>Ireland</b>	Kevin McLoughlin	<i>Dublin</i>
▶ <b>Israel</b>	Sharon Shulman	<i>Tel Aviv</i>
▶ <b>Italy</b>	Mario Ferrol	<i>Milan</i>
	Gaetano Pizzitola	<i>Rome</i>
▶ <b>Japan</b>	Kai Hielscher	<i>Tokyo</i>
▶ <b>Korea</b>	Kyung-Tae Ko	<i>Seoul</i>
▶ <b>Luxembourg</b>	Frank Muntendam	<i>Luxembourg</i>
▶ <b>Malaysia</b>	Hock Khoon Lee	<i>Kuala Lumpur</i>
▶ <b>Mexico</b>	Koen van 't Hek	<i>Mexico City</i>
▶ <b>Middle East</b>	Tobias Lintvelt	<i>Abu Dhabi</i>
▶ <b>Middle East</b>	Michelle Kotze	<i>Dubai</i>
▶ <b>Netherlands</b>	Johan van den Bos	<i>Amsterdam</i>
▶ <b>Norway</b>	Oyvind Hovland	<i>Oslo</i>
▶ <b>Peru</b>	Roberto Cores	<i>Lima</i>
▶ <b>Philippines</b>	Ma Fides Balili	<i>Makati City</i>
▶ <b>Poland</b>	Lukasz Ziolek	<i>Warsaw</i>
▶ <b>Portugal</b>	Antonio Neves	<i>Lisbon</i>
▶ <b>Russia</b>	Vladimir Zheltonogov	<i>Moscow</i>
▶ <b>Singapore</b>	Andy Baik	<i>Singapore</i>
▶ <b>South Africa</b>	Corlie Hazell	<i>Johannesburg</i>
▶ <b>Spain</b>	Federico Linares	<i>Madrid</i>
▶ <b>Sweden</b>	Erik Hultman	<i>Stockholm</i>
▶ <b>Switzerland</b>	Markus F. Huber	<i>Zurich</i>
▶ <b>Taiwan</b>	Jennifer Williams	<i>Taipei</i>
▶ <b>Thailand</b>	Anthony Loh	<i>Bangkok</i>
▶ <b>Turkey</b>	Feridun Gungor	<i>Istanbul</i>
▶ <b>United Kingdom</b>	Matthew Mealey	<i>London</i>
	Jim Charlton	<i>London</i>
▶ <b>United States</b>	Jeffrey Michalak	<i>Detroit</i>
▶ <b>Venezuela</b>	Jose Velazquez	<i>Caracas</i>
▶ <b>Vietnam</b>	Carlos Llanes Navarro	<i>Bogota</i>

Ernst & Young

Assurance | Tax | Transactions | Advisory

### About Ernst & Young

Ernst & Young is a global leader in assurance, tax, transaction and advisory services. Worldwide, our 141,000 people are united by our shared values and an unwavering commitment to quality. We make a difference by helping our people, our clients and our wider communities achieve their potential.

Ernst & Young refers to the global organization of member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit [www.ey.com](http://www.ey.com).

### International Tax Services

About Ernst & Young's International Tax services practice

Our dedicated international tax professionals assist our clients with their cross-border tax structuring, planning, reporting and risk management. We work with you to build proactive and truly integrated global tax strategies that address the tax risks of today's businesses and achieve sustainable growth. It's how Ernst & Young makes a difference.

[www.ey.com](http://www.ey.com)

© 2010 EYGM Limited.  
All Rights Reserved.

EYG no. CM2159

*This publication contains information in summary form and is therefore intended for general guidance only. It is not intended to be a substitute for detailed research or the exercise of professional judgment. Neither EYGM Limited nor any other member of the global Ernst & Young organization can accept any responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication. On any specific matter, reference should be made to the appropriate advisor.*