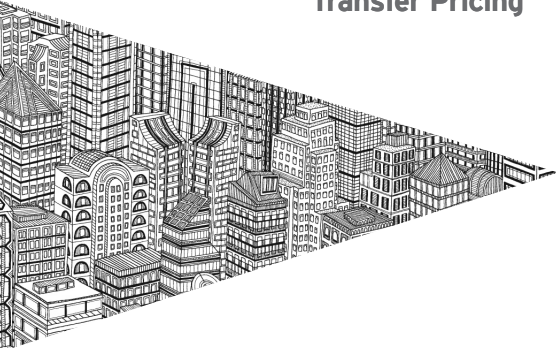


International Tax Alert

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Transfer Pricing



Turkey: Tax Authority continues transfer pricing audits at pharmaceutical companies

Executive summary

The Turkish tax authority continued its transfer pricing audits at pharmaceutical companies uninterrupted in 2009. In the tax inspections conducted for previous years taking into account the 5 year statute of limitations defined under the Tax Procedures Code, tax inspectors put forward external pricing benchmarks for the active ingredients purchased from related parties.

The reports, drawn up at the end of the inspections, claim the external benchmarks are for active ingredients identical in terms of physical features and formula to related party purchases by the pharmaceutical company under inspection. Claiming there are no factors that could cause the price difference between the active ingredients purchased by the company under inspection and external benchmarks with identical bioequivalence and bioavailability, inspectors impose tax assessments on the pharmaceutical companies on the grounds of disguised profit distribution.

Now that the end of 2009 is drawing near, transfer pricing tax inspection reports and tax penalty notices for the fiscal period 2004 are being delivered to pharmaceutical companies. The settlement or litigation process, which has almost become a routine for pharmaceutical companies, has now begun for the year 2004.

Detailed discussion

Overview of the Inspections

Taking into account the 5 year statute of limitations under the Tax Procedures Code, the tax inspectors began to conduct limited transfer pricing inspections of pharmaceutical companies in late 2007 for the fiscal period 2002, related to the purchases of active ingredients from group companies.

The main purpose of the inspections was to test the arm's length character of the transfer prices.

Though the regulation based on OECD transfer pricing guidelines has actually been effective in Turkey since 2007, a law which could constitute basis for the inspections and which prevented disguised profit distribution through transfer pricing existed in 2002 as well.

According to the provisions effective before 2007, companies would be considered to have distributed profits wholly or partially in a disguised manner, if they engaged in transactions with their related parties at prices remarkably lower or higher than comparables.

In the inspections carried out based on these grounds, the transfer prices have been compared with external benchmarks. Tax inspection reports were drawn up and tax assessments were made for almost all pharmaceutical

companies under inspection, due to the significant price differences revealed in the reports.

Some companies reached settlement with the tax authority regarding the assessments and paid the settled amounts, but many other pharmaceutical companies resorted to litigation. At this point, there are cases concluded both in the favor of the taxpayer and the tax authority.

In a lawsuit concluded in the favor of the taxpayer, the tax court states that a proper benchmark study was not performed; whether the taxpayer and the company considered as a benchmark by the tax inspector were identical in terms of type of activity, organization, profitability, equity, etc was not demonstrated; and existence of the same physical and chemical features between the two active ingredients was not sufficient to consider both these active ingredients as comparable.

In another lawsuit that was concluded against the taxpayer, the tax court stated that the taxpayer's purchases of active ingredients with the same physical and chemical features and of similar quantities at a price almost 90-fold higher than the prices applied by other companies proved the existence of disguised profit distribution.

Basis of the Reports

One of the main reference points of the reports drawn up for tax inspections conducted

simultaneously in almost all pharmaceutical companies are the CAS (Chemical Abstract Service) registry numbers that identify the molecular structure of the active ingredients purchased from related parties.

The prices at which active ingredients with the same CAS registry number, therefore same molecular structure, are purchased by other pharmaceutical companies operating in the sector are identified and the lowest price among these prices is put forward as the benchmark for the active ingredient purchased by the company under inspection.

Similarly, active ingredients that have the same physical features, closed formula, bioequivalence and bioavailability as the active ingredients purchased by the pharmaceutical company under inspection may also be considered as benchmarks.

On the grounds that there would not be any factors that could cause a price difference if all these features were the same, it is claimed that the profits are distributed to group companies in a disguised manner if the prices applied are higher than the benchmarks.

On the other hand, the tax inspection report does not provide any information about the pharmaceutical company from which the benchmarks are obtained and these benchmarks are referred to as "secret comparables".

Tax authority's approach

Transfer pricing tax inspections that started initially in late 2007 for the fiscal period 2002 became more frequent in the following years. At each year-end, the tax authority conducts inspections

of pharmaceutical companies regarding the relevant past year, taking into account the statute of limitations.

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EYG no. CM1763

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