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Subject:

THE DRAFT COMMUNIQUÉ SERIAL NO. 4 AMENDING THE GENERAL COMMUNIQUÉ ON DISGUISED PROFIT DISTRIBUTION VIA TRANSFER PRICING SERIAL NO. 3 WAS PUBLISHED

As it is known through the Presidential Decision dated 25.02.2020 and numbered 2151 published in the Official Gazette with number 31050, transfer pricing reporting standards in line with the Action Plan 13 of the Base Erosion and Profit Shifting (BEPS) of the Organization for Economic Cooperation and Development (OECD) were introduced. This time, Draft Communiqué Serial No. 4 Amending the General Communiqué on Disguised Profit Distribution Via Transfer Pricing, with respect to the said decision, has been published and presented to the opinions and suggestions of the taxpayers

The draft communiqué provides details on the three-tiered reporting standards (Country-by-Country Reporting, Master File and Annual Transfer Pricing Report) prepared in the Base Erosion and Profit Shifting (BEPS) Action Plan No: 13 of the Organization for Economic Cooperation and Development (OECD) and included in the OECD's Transfer Pricing Guidelines. With the help of some examples, the draft also clarifies the "10% share of partnership" concept which can be interpreted differently in the definition of related party.

The Revenue Administration is currently working to prepare the draft communiqué and its annexes and to make them ready for publication and the opinions and recommendations intended for developing, amending or contributing to the topics covered by the existing draft can be conveyed to transferfiyatlandirmasi@gelirler.gov.tr e-mail address by May 1, 2020.

Important topics and explanations regarding the draft communiqué are provided below.

1. AMENDMENTS TO DOCUMENTATION OBLIGATIONS

1.1. COUNTRY-BY-COUNTRY REPORTING

1.1.1. Relevant Definitions

Group: A collection of enterprises related through ownership or control such that it is either required to prepare Consolidated Financial Statements for financial reporting purposes under applicable accounting principles or would be so required if equity interests in any of the enterprises were traded on a public securities exchange.

Multinational Enterprise Group (MNE): Any Group that includes two or more enterprises the tax residence for which is in different jurisdictions, or includes an enterprise that is resident for tax purposes in one jurisdiction and is subject to tax with respect to the business carried out through a permanent establishment in another jurisdiction.

Constituent entity: Any separate business unit, workplace or permanent representative of a multinational enterprise group included in its consolidated financial statements.

Reporting entity: The enterprise that will submit a country-by-country report on behalf of a group of multinational enterprises. The ultimate parent entity submits the country-by-country report to the Administration in a multinational enterprise group whose ultimate parent entity is resident in Turkey. However, the surrogate parent entity or any of the enterprises of the multinational enterprises group resident in Turkey can also become the reporting entity.

Ultimate parent entity: Constituent entity of an MNE Group that owns directly or indirectly a sufficient interest in one or more other Constituent Entities of such MNE Group such that it is required to prepare Consolidated Financial Statements under accounting principles generally applied in its jurisdiction of tax residence, or would be so required if its equity interests were traded on a public securities exchange in its jurisdiction of tax residence.

Surrogate parent entity: A Constituent Entity that has been appointed by such MNE Group, as a sole substitute for the Ultimate Parent Entity, to file the Country-by-Country Report in that Constituent Entity's jurisdiction of tax residence, on behalf of such MNE Group.

Competent authority agreement: An agreement signed between the competent authorities of the countries that are parties to an international convention allowing for the exchange of country-by-country reports between the contracting parties.

International convention: "Convention on Mutual Administrative Assistance in Tax Matters" approved upon the Resolution of the Council of Ministers No. 2017/10969 of October 30, 2017 as well as bilateral or multilateral tax agreements or information exchange agreements on tax matters intended for granting statutory authority for information exchange on tax matters between/among countries.

Systemic failure: Suspension of the country-by-country reporting by the revenue administration of the other contracting state of the agreement on the exchange of the country-by-country report or its failure to automatically submit to the Administration a country-by-country report filed to the revenue administration of its own country.

1.1.2. Reporting Obligation

The Country-by-Country Report will be drawn up by the ultimate parent entity or surrogate parent entity resident in Turkey for the MNE Group whose total consolidated group revenue is EUR 750 million and higher.

However, if the aforementioned threshold is exceeded and one of the following conditions materializes in cases where the ultimate parent entity or the surrogate parent entity is not resident in Turkey, the entity resident in Turkey electronically submits the country-by-country report to the Administration as the surrogate parent entity:

1. Where there is no obligation of country-by-country reporting in the country where ultimate parent entity or surrogate parent entity is resident,
2. Where there is an obligation of country-by-country reporting in the country where ultimate parent entity or surrogate parent entity is resident and there is an international agreement applicable between the Administration and the administration of the country where ultimate parent entity or surrogate parent entity is resident but there is no competent authority agreement applicable regarding the exchange of country-by-country reporting information,
3. Where there is an obligation of country-by-country reporting in the country where ultimate parent entity or surrogate parent entity is resident, there is an international agreement applicable between the Administration and the administration of the country where ultimate parent entity or surrogate parent entity is resident and there is also a competent authority agreement applicable regarding the exchange of country-by-country reporting information but there is a systemic failure concerning information exchange.

In case of more than one entity resident in Turkey, only one of these entities will submit country-by-country report.

There is no exemption for country-by-country reporting and the multinational enterprise group exceeding the specified threshold for the reported accounting period must prepare a country-by-country report and submit it to the Administration electronically.

1.1.3. Calculation of the Consolidated Group Revenue and EUR 750 Million Threshold

Consolidated group revenue to be taken into consideration for the relevant reporting period will be determined based on the consolidated financial statements of the accounting period prior to the reported accounting period. **For example, the total consolidated revenue of the group in its consolidated financial statements for 2018 will be taken into consideration for the 2019 CbCR.** *If the total consolidated revenue of the MNE group is less than EUR 750 million for the 2018 accounting period, then no CbCR will be drawn up for the 2019 accounting period. However, if the total consolidated revenue of the MNE group is equivalent to or higher than EUR 750 million for the 2019 accounting period, then a CbCR will be drawn up for the 2020 accounting period.*

If consolidated financial statements are issued in a currency other than Euro, EUR 750 million will be calculated by considering the average buying rate of exchange calculated by the Central Bank for the previous accounting period. **For instance, the average buying rate of exchange set by the Central Bank for 2018 will be used for determining the reporting threshold for 2019 CbCR.** If a different currency is used for the preparation of consolidated financial statements, explanations about this must be included in the country-by-country report.

1.1.4. Scope of Reporting

The Country-by-Country Report is composed of 3 tables. Information that must be included in these tables is summarized below:

Table 1 Concerning <u>each country</u> where the MNE Group is operating;	Table 2 Concerning <u>each entity</u> of an MNE Group;	Table 3
<ul style="list-style-type: none">• Amount of revenue,- Profit/loss before tax,- Paid income/corporate tax,- Accrued income/corporate tax,- Capital,- Accumulated earnings,- The number of employees and- Tangible assets other than cash and cash equivalents	<ul style="list-style-type: none">- Trade name of the entity,- if the country where the entity is resident is different from the country where it is resident in terms of tax (tax jurisdiction), the name of the tax jurisdiction and- main activities of each entity	<ul style="list-style-type: none">• Additional Explanations

1.1.5. Notification

Members of an MNE Group eligible for reporting must notify the Revenue Administration of:

- Whether they are UPEs or SPEs,
- Which entity of the MNE Group is the reporting entity and
- Information about the reported accounting period.

Notifications for the first country-by-country reports will be submitted to the Revenue Administration by filling in the "notification form for country-by-country reporting" until **11:59 p.m. on August 31, 2020** while the relevant information will be submitted for the subsequent years **until the end of June** every year.

Taxpayers operating on the basis of a calendar year must submit:

- the 2019 CbCR until August 31, 2020
- the 2020 CbCR and the CbCRs for the subsequent periods until the end of June of each year.

The notification form will be filled in by **the multinational enterprise groups whose consolidated revenue for the accounting period prior to the reported accounting period is equivalent to and higher than EUR 750 million.**

No paper notification form (by hand or by mail) will not be accepted.

If the ultimate parent entity of an MNE group is resident in Turkey, this notification must be submitted only by the ultimate parent entity on behalf of the multinational enterprise group. This notification may be submitted by one of the group members resident in Turkey on behalf of an MNE group whose ultimate parent entity is not resident in Turkey.

1.1.6. Reporting

The Country-By-Country Report will be submitted by logging in with the current e-Return username and password by clicking on the link ((www.gib.gov.tr)/BTRANS) from the website of the Revenue Administration.

Data format and standard for the aforementioned information regarding the country-by-country reporting will be announced by the Ministry of Treasury and Finance (through BTRANS of the Revenue Administration). Amendments to the information submission format and standards such as addition, omission and setting as a compulsory field will be separately announced (through BTRANS of the Revenue Administration). Data will be transmitted to the Administration via this system. The reporting entity must finalize its BTRANS applications prior to the date of transmitting the first data.

A country-by-country report drawn up on behalf of an MNE group whose ultimate parent entity is resident in Turkey may be mutually shared with the tax administrations of other countries within the framework of the bilateral and/or multilateral international agreements to which Turkey is a party. The list of countries subject to mutual information exchange will be announced by the Administration. **There is no list of countries disclosed to the public as of the date when the draft communiqué is published.**

1.2. MASTER FILE

The master file is composed of five main categories covering:

- (A) Organizational Structure,
 - 1. An information diagram indicating the group's legal and shareholding structure as well as the geographical location of active entities.
- (B) Description of Business Activities,
 - 1. Basis constituents of the operating income,
 - 2. Description of the supply chain regarding the products and services corresponding to more than 5% of the group turnover as well as top five products or services offered by the group,
 - 3. Information on major geographical markets in terms of the aforementioned products and services,

4. A table showing significant service contracts concluded between the members of the group other than R&D services and the pertaining brief explanations as well as explanations on the transfer pricing policy intended for setting the price for intra-group services and the breakdown of service costs and on major locations offering significant services,
5. Functional analysis explaining the contributions made to the value created by each group entity within the group on the basis of important functions performed, significant risks assumed and important assets used,
6. Description of significant restructuring, transfer and sales operations of the entities during the relevant accounting period.

(C) Intangibles,

1. Explanations on the group's detailed strategy for the development, ownership and use of intangible rights, and explanations on the location of major R&D facilities and the R&D management center,
2. Intangible rights possessed by the group for the purposes of transfer pricing and a list indicating which group member possesses such rights,
3. A list of significant agreements concluded between the related enterprises with regard to intangible rights, including cost contribution arrangements, basic research service agreements and license agreements,
4. Explanatory information on the group's transfer pricing policies concerning R&D and intangible rights,
5. General explanations on significant intangible transfers between related parties during the accounting period (including relevant entities, countries and payments effected).

(D) Intra-Group Financial Transactions,

1. Explanations on how the group is financed, including significant financial agreements concluded with unrelated parties,
2. Definitions on the MNE members performing the function of providing the central finance to the Group (including the effective management center of such entities and the country in which they are established),
3. General explanations on the group's general transfer pricing policies regarding the finance agreements between the related parties

(E) Finance and Tax Status

1. Consolidated financial statements of the group drawn up regarding the accounting period for the purposes of financial reporting, legislation, internal management, taxes or other purposes,
2. A list of the group's unilateral advance pricing agreements in force and the advance rulings of income distribution between countries as issued by other tax offices and summary information thereon

First Master File will be prepared:

- For the 2019 accounting period by the taxpayers operating on the basis of a calendar year,
- For the accounting period starting from January 1, 2019 by the taxpayers subject to a special accounting period.

It is compulsory to prepare the Master File until the end of the accounting period following the relevant accounting period and to submit it to the Revenue Administration or those authorized to conduct a tax inspection upon request following the expiry of this period. For example, the taxpayers whose accounting period is between January 1, 2019 and December 31, 2019 must draw up a master file until December 31, 2020.

A master file will be drawn up by the corporate taxpayers which are part of an MNE Group and whose asset size in the balance sheet attached to corporate tax return declaration of the previous accounting period and net sales amount in the income statement are both TRY 500 million and higher. For instance, the balance sheet and income statement amounts in the corporate tax return intended for 2018 will be taken into account for threshold of preparing a Master File for 2019.

1.3. ANNUAL TRANSFER PRICING REPORT

Format of the annual transfer pricing report is already included in the General Communiqué on Transfer Pricing No.1.

The Draft Communiqué No. 4 makes the following new additions to the list **of information and documents that must be included in the annual transfer pricing report:**

- The category of transactions completed with related and unrelated parties within the subject year and the amount of these transactions by country (the list in the Communiqué No. 1 currently asks for "*the amount of transactions completed with related and unrelated parties within the subject year and the relevant documents such as invoices, receipts, etc.*")
- If a multiannual analysis is conducted for the determination of the arm's length price, information on the relevant reasons
- A sample for each of the current unilateral, bilateral or multilateral advance pricing agreements,
- Financial information employed for the application of transfer pricing method

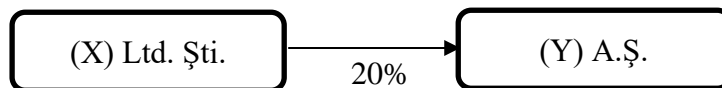
2. CALCULATION OF THE 10% THRESHOLD FOR THE RELATED PARTY DEFINITION

As for the condition of "**possessing shareholding, voting and dividend rights by a minimum of 10%**" sought for being considered as a "related party" in Article 13(2) of the Corporate Tax Law regulating "Disguised Profit Distribution Via Transfer Pricing", the following addition provision was already added by the Law No. 6728 effective from August 9, 2016: "**Where parties directly or indirectly possess voting or dividend rights by a minimum of 10% without any partnership relation, the parties shall be considered as related parties and these ratios shall be collectively taken into consideration for related parties**".

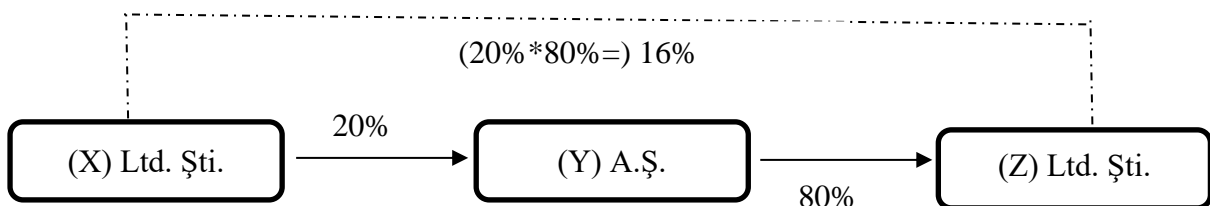
In order to eliminate any potential hesitation regarding implementation, the Draft Communiqué covers 7 examples on how to calculate and apply the 10% threshold. Accordingly, in case of a direct partnership, a shareholder with a partnership share below 10% will not be considered as a related party as per the Transfer Pricing legislation.

Two examples are provided below.

Example 1: (X) Ltd. Şti. owns (Y) A.Ş. by 20%. In this case, since the level of the relationship between (X) and (Y) meets the 10% threshold stipulated in the Law, transactions between these two companies are evaluated within the scope of disguised profit distribution provisions.



Example 2: (X) Ltd. Şti. owns (Y) A.Ş. by 20% and (Y) A.Ş. owns (Z) Ltd. Şti. by 80%. In this case, since (X) and (Z) are related parties and the level of the relationship between them ((20%*80%=) 16%) meets the 10% threshold stipulated in the Law, transactions between (X) and (Z) are evaluated within the scope of disguised profit distribution provisions.



3. ADDITIONAL EXPLANATION ON INTRA-GROUP SERVICES

The following phrase was added by Article 8 of the Draft Communiqué to the Section "11.3. Determination of the Arm's Length Price for Intra-Group Services" under the General Communiqué on Transfer Pricing No. 1: "On the other hand, the payments effected due to any intra-group service shall be taxed depending on the nature of the service received by also considering the provisions of domestic law as well as the provisions of the relevant double taxation treaties." . It has been emphasized by the Revenue Administration once again that the nature of intra group services are to be determined under the considerations of double tax treaties and domestic tax law.

We would like to state that we expect the draft communiqué in question to be published soon after the feedback from taxpayers and relevant parties is taken into consideration.

[Click](#) for the said Draft Communiqué.

[Click](#) for accessing ANNEX-5 - Notification Form for Country-by-Country Reporting.

[Click](#) for accessing the Explanations on How to Fill in ANNEX-5 Notification Form for Country-by-Country Reporting.

[Click](#) for accessing ANNEX-6 Country-by-Country Report.

[Click](#) for accessing the Explanations on How to Fill in ANNEX-6 Country-by-Country Report.

Sincerely,

**DENGE İSTANBUL YEMİNLİ
MALİ MÜŞAVİRLİK A.Ş.**

ANNEX:

Announcement of the Revenue Administration

(*) The remarks in our circular are for informational purposes only. We recommend that the opinion and support of a qualified counsellor be received before establishing final transactions on the questionable matters. Our company shall not be held responsible for any damages to be incurred as a result of transactions to be made solely on the basis of the statements in our circular.

(**) For opinions, criticisms and questions about our circular, you can contact our specialists the contact information of whom is provided below.

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