

Litigation - Turkey

Council of State upholds tax courts' decision on capital replenishment funds

Contributed by **Cerrahoğlu Law Firm**

September 28 2010

Recent disputes arose between the Tax Authority and the Turkish subsidiaries of multinational pharmaceutical companies regarding capital replenishment funds (for further details please see "[Council of State to decide on tax courts' decisions on capital replenishment funds](#)").

The tax inspectors claimed that the Turkish subsidiaries were providing continuous sales and marketing services to their parent companies abroad free of charge. Thus, they had incurred continuous losses and covered such losses through their capital replenishment funds. According to the tax inspectors, such capital replenishment funds provided to these companies from abroad by their shareholders should be considered as service fees.

The companies filed lawsuits against the tax audit reports, in which the tax courts rendered contradictory decisions.

In one case regarding a company which incurred losses throughout its seven-year existence, the tax court dismissed the case based on the reasoning that the company had acted as the marketing department of the parent company, and that although it had incurred losses for a number of years from the the company's incorporation, it maintained its economic existence through receiving payments from the parent company abroad under the title of 'capital replenishment funds'.

On appeal before the Council of State, the Fourth Chamber of the Council of State rejected the appeal in a majority decision. The Council of State's decision repeated the same claims stated in the tax report and no additional investigation was made into the cause of the losses.

In the Council of State's decision it stated that although it is acceptable for a company to incur losses for a certain period of time in order to establish a market with the expectation of making a profit in future, in this case the company incurred continuous losses starting from the company's establishment until the date on which the company merged with another company. Taking into consideration that the shareholders that sent the capital replenishment funds to the company belong to the same group of companies from which the company had been making its wholesale purchases, the Council of State concluded that the company had continued its activities despite continuous losses because the parent company had been making sales to the Turkish market and generating income through the company. Thus, the company continued its activity despite its losses and the capital replenishment funds had been sent because the company was indirectly providing income to the parent company. Therefore, the Tax Authority's assessment was correct.

The company has appealed the decision before the same chamber of the Council of State.

For further information on this topic please contact [Ayşegül Gürsoy](#) at Cerrahoğlu Law Firm by telephone (+90 212 355 3000), fax (+90 212 266 3900) or email (aysegul.gursoy@cerrahoglu.av.tr).