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Doing Business in Turkey

In Turkey for 30 years

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Contents

1. Turkish Market Overview

Driven by private consumption and supported by a stable macroeconomic policy framework, the Turkish economy has grown significantly since the country emerged from the 2001 financial crisis. Between 2002 and 2008, Turkey's GDP experienced an annual average growth of 5.8%, versus 1.8% in the EU. Due to global turmoil in 2009 Turkey's GDP declined to US$614 bn, but rebounded in 2010, reaching US$729 bn and making Turkey the 16th largest economy in the world.

Restructuring of the banking sector, monetary discipline based on independence of the Central Bank and a floating exchange rate regime, tight fiscal policy, public administration reform, and the EU accession process with reform packages enacted by the Parliament all contributed to the transformation of the country after the 2001 crisis.

Foreign Direct Investment (FDI) inflows to Turkey declined in 2009 from a high of US$22 bn in 2007. FDI remained low in 2010 at US$8.9 bn, although this was sufficient for Turkey to be ranked 15th globally.

Since the 2001 crisis the economy has been buoyant. It remains two notches below investment-grade credit rating but inflation is in single figures and the economic outlook is promising. Public debt is below 50%. Turkey is knocking on the door of the BRICs club of emerging giants and today it is perceived as 'Europe's BRIC' or 'the China of Europe'. Some economists suggest that over the next decade, Turkey's growth will match or exceed that of any country except China and India. Others predict it could become the world's 10th biggest economy by 2050.

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The new Turkish Commercial Code comes into effect from 01 July 2012.

Key Attractions of Turkey

- Turkey is located at a close proximity to Europe (two three hours' flight to major European destinations), the Middle East and the Caucasus. Turkey benefits from its location as a bridge between Europe and Asia. It is also acts as an energy corridor connecting these two continents.

- Turkey entered a customs union with the EU in 1996 and has been an EU accession candidate since 2005. This has resulted in the expansion of trade relations with Europe, which now accounts for 44% of Turkey's foreign trade.

- Turkey offers an accessible, skilled and cost-effective workforce, providing the fourth largest labour force amongst EU members and accession countries. It boasts a large population of over 74 m people, with an average of 29, over a decade lower than the EU figure.

- The Turkish government provides various tax and non-tax incentives to foreign investors, in line with those provided to domestic companies. These include customs and VAT exemptions on various imported or locally delivered goods, including machinery and equipment, as well as priority regions offering incentives such as free land and energy support. Investors are also able to benefit from R&D support and market research with the aim of encouraging exports and increasing the competitiveness of firms in international markets.

- The Turkish government has also introduced flexible exchange rate policies and liberal import regulations in order to promote and sustain foreign investment.

- In recent years, Turkish banks have taken an increasingly large role in financing project finance deals, benefiting in many cases from increasingly liquid balance sheets.

- The Turkish legal framework offers a level playing field to foreign investors and domestic companies. Foreign ownership is unrestricted, with no pre-entry screening requirements.

- A new commercial code nr. 6102 is currently published in the Official Gazette on 14 February 2011. The Code aims to integrate the local applications with EU law, improve transparency, protect minority rights and strengthen corporate governance principles. The new Turkish Commercial Code comes into effect from 01 July 2012.

During the peak of the global crisis in 2009, the Turkish Central Bank's prime lending rate was as high as 16.75%, compared with 6.25% in July 2010.

Challenges are Important

- While Turkey did not have a subprime mortgage issue, like other emerging markets, it was affected by the ongoing global credit turmoil (i.e. increasing CPI due to rising oil and food prices).

- During the peak of the global crisis in 2009, the Turkish Central Bank's prime lending rate was as high as 16.75%, compared with 6.25% in July 2010.

- There is a split between the east and the west of the country; economic development, investment opportunities, infrastructure and skilled staff are concentrated in the west.

- Although Turkey is moving towards adopting International Financial Reporting Standards (IFRS), this is still a work in progress. In practice, accounting standards vary from company to company.

- Turkey suffers from rising energy prices. Up to 90% of its oil and 97% of its gas resources are imported from Russia and the Middle East.

- The country's current account deficit is large. In recent years it has been comfortably financed by foreign direct investment, but long term this could lead (as it has in the past) to inflation and currency instability.

- In spite of interest rates swiftly shrinking down to record low levels, they are still high in comparison to most European countries.

In line with rising GDP, retail sales are expected to reach 448 bn Turkish Lira in 2013.

Key Industries in Turkey

- Travel and tourism is one of Turkey's most dynamic industries. This industry defied the economic crisis in 2009, and is booming in 2010, largely on the back of the Arab Spring, with Turkey benefiting from decreased tourism to its Middle Eastern neighbours. Tourist numbers in the first five months of 2010 were already up 14.56% over January-May 2010. The depreciation of the Turkish Lira (TL) against the US Dollar, as well as generally competitive prices, made Turkey a favourable destination for foreign tourists. Turkey was visited by 27.3 m and 28.5 m tourists in 2009 and 2010, respectively. With this number of tourists, Turkey was ranked the seventh most-visited country in the world. However, while tourist numbers continue to increase, revenue has shrunk, dropping from US$21.3 bn in 2009 to US$20.8 bn in 2010. The tourism sector aims to reach the top five countries in the world in terms of both tourist numbers and tourism revenue by 2023.

- Textiles and clothing is one of the most important industries of the Turkish economy and the country's foreign trade. These industries have an annual production value of US$14.6 bn and had a 13% share in total export volume in 2010. There are more than 35,000 textile and clothing companies in Turkey and the country is a major player in the world clothing industry. The Turkish clothing industry is the second-largest supplier to the EU. It has a share of 4.6% in global woven clothing exports and ranks in the top five exporting countries worldwide. The Turkish textile and clothing industry is competitive on a global scale thanks to its high quality and wide product range.

- Since the start of the new millennium, in particular, Turkey has attracted foreign direct investment. This positive economic development was felt more intensely in certain industries – retail in particular. The Turkish retail industry still featured a traditional structure until the beginning of the 2000s; its modernisation period then began and gained momentum, with a tremendous positive effect on the national economy. According to Planet Retail's report, consumer expenditure in Turkey is expected to rise to 948 bn Turkish Lira in 2013. Retail sales, which stood at 23 bn Turkish Lira in 1998, grew to 128 bn Turkish Lira in 2003, 329 bn Turkish Lira in 2008, and 317 bn Turkish Lira in 2009. In line with rising GDP, retail sales are expected to reach 448 bn Turkish Lira in 2013.

- Between 2002 and 2008, the Turkish construction sector experienced a significant compound annual real growth of 6.3%, higher than Turkey's GDP growth in the same period. In 2010 expenditure in the construction sector increased by 17.1%, with respect to the same term in the previous year. Key drivers include increased housing needs, eased housing credits allowing people to upgrade their homes, an increase in the number of large-scale Turkish contracting firms, and the growth of the building materials sector. Turkey is currently a market leader in terms of cement exports and is in strict competition with Egypt to be the ruling cement producer of the whole Mediterranean basin. Turkey's crude steel production in 201 reached 29.1 m tonnes, a growth of 15.2% over the previous year. Accordingly, Turkey is ranked tenth worldwide for unprocessed steel production.

The automotive industry is very important. At present, Turkey is the largest producer of buses in Europe. It is also responsible for more than 7% of Europe's motor vehicle production. Turkey's automotive exports grew by 20% in 2010, reaching US$15.9 bn. The total number of vehicles produced was in the region of 1.094 million in 2010.

- At present, Turkey's energy and utilities sector is attracting significant interest from foreign investors, following the split of Turkey's main energy provider into many regional companies. The government has been privatising these companies, providing significant opportunity for investment; however there is some public opposition. The government plans to complete the sell off of distribution companies by the end of 2010. It should be noted that the share of private sector interest in electricity distribution was only 20.1% in 2008. Additionally, Turkey wants to generate 5% of its electricity from nuclear energy by 2020 while the share of renewable energy by 2023 is targeted at 20%. Currently, hydropower accounts for approximately one-third of the electricity generated in Turkey. The country is heavily reliant on imported fuel supplies for the remainder of its power needs.

- The Turkish Electricity Transmission Company estimates that Turkey's demand for electricity will increase at an annual rate of 6.0% between 2009 and 2023. Therefore government encourages investors or energy investments in Turkey. The total amount of investments to be made to meet the energy demand in Turkey until 2023 is estimated around US$130bn.

- Since transportation and logistics is one of the main pillars of both national and international trade, the Turkish government is making ongoing investments to create a new infrastructure. According to 'Strategic Plan 2009-2013' by the Ministry of Transportation, highways are given the utmost importance and will be subject to an important amount of investment.

- Despite the uncertainties caused by its being in a transition period, the Turkish healthcare sector offers great opportunities for the private sector, which is forecast to be a significant contributor of growth going forward. A total of 13 significant deals took place between 2007 and 2009 in the healthcare industry, with a total announced deal value exceeding US$850 m. Financial and strategic investors search for investment opportunities in the Turkish healthcare market due to growth prospects and the growing number of people who can afford private healthcare.

- TL interest rates have decreased consistently since September 2008 due to a series of rate cuts by the Central Bank (CBT). As a result of the macro uncertainties and increasing credit risk after the credit crisis, banks are reluctant to reflect the CBT's rate cuts to their loan rates as fast as the decrease in the cost of deposits. Given the maturity mismatch on bank's balance sheets with deposits having one and half month maturity versus an average of one year asset duration, the decline in interest rates helped to improve the Bank's net interest margin in the past 2 years. Strong asset structure and high CAR (Capital Adequacy Ratio) due to the close monitoring of the regulatory bodies resulted in Turkey's banks being in a secure position in the financial crisis. Soundness of the Turkish economy and the finance sector has been proved during the financial crisis, and the financial sector has acted as the growth engine of the economy.

- On the back of the recovery in economic activity in 2010, inflation has increased and is forecast to be 6.9% at year-end 2011, above the target of 5.5%. The CBT has decreased one-week repo rate (the policy rate) to a rare low of 6.25% in June 2011.

- Additionally, the fact that maturities of liabilities are shorter than those of assets in the Turkish banking sector exposes the sector to liquidity and interest rate risk, which increases the sensitivity of the banking system to shocks. In this regard, starting from the year 2011, the Turkish lira required reserve ratio, which is currently at 6%, is differentiated according to the maturity structure of deposits and set as higher for short-term maturities and lower for long-term maturities.

- In this respect, a lower interest rate, combined with higher required reserve ratios would serve as a more effective policy mix. Moreover, with regard to policy measures to enhance financial stability, it will be useful to differentiate the required reserve ratios for different maturities of TL deposits in order to encourage longer-term funding and to widen the scope of the reserve requirements.

- The main challenge for the Turkish Banking Sector is the decreasing interest margins due to the rate cuts by CBT. In a low interest rate environment, banks focus on commission generation. Volume growth, expanding insurance and asset management businesses, and the introduction of new financial instruments will be the main trends in this environment in the year 2011.

2. Legal Environment: Specificities

Company Structures

A company is an incorporated entity with a legal status separate and distinct from its owners that allows it to sue and be sued in its own name. The TCC provides several company structures in Turkey: joint stock companies, limited liability companies, collective companies, partnerships limited by shares and cooperative associations. The legal differences between those company structures mainly concern the allocation of liability and the legal form of the entity. However, largely due to the favourable position concerning the liabilities borne by shareholders, joint stock companies and limited liability companies are the corporate structures in Turkey most commonly chosen by foreign investors, along with the other business setup forms of branch offices and liaison offices.

Two types of companies, namely joint stock companies (JSC) and limited liability companies (LLC), are those in which shareholders are not liable for the debts of the company in terms of their personal assets. There are some basic differences between these two types of companies.

An LLC can be incorporated by at least two individuals or corporations and the number of the shareholders cannot exceed 50, while a JSC can be incorporated by at least five individuals or corporations. A JSC can issue debentures, while a LLC is prohibited from doing so. A JSC can go public while a LLC cannot offer its shares to the public. A statutory auditor is required for a LLC, only if and when it has more than 20 partners, while it is required for a JSC regardless of number of shareholders.

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Branch

A branch is a legal entity registered with the Trade Registry and represented by a representative/ branch manager. Even though a branch has separate capital, which is allocated by the head office, it may not have a separate articles of association and consequently must act within the same field of activity as that of its head office. Even though the branch is dependent on its head office in internal relations, it may act independently and trade in its own account in external relations. It is considered to have separate tax personality than that of its head office.

A branch should be represented by a representative/branch manager with full authority, who is residing in Turkey. To this end, either a Turkish citizen or a foreigner who has work and residence permits may be appointed branch representative. However, the representatives of legal entity licensees having full authority to manage and represent the entity have to be Turkish citizens. Every branch shall use the parent company name by indicating that it is a branch. The branch model is more frequently used, especially in banking, and in certain fields of business (e.g. brokerage, portfolio management, etc.) it is not allowed.

Liaison Office

A liaison office, often also called 'representative office', is primarily established to provide preparatory and auxiliary services. (i.e. gathering information on the Turkish economy, customers, suppliers and competitors); performing surveys on markets and the activities of distributors, agents or licensees; following developments and changes in the local regulations and (if necessary) lobbying; surveying the possibility of establishing a branch or incorporation in Turkey, providing information relating to the activities of the head office and representing its products to suppliers or customers as long as this does not constitute active solicitation, etc. for its head office. It is prohibited from carrying out any kind of 'commercial activities' in Turkey.

Liaison offices may not act for profit, although they are entitled to employ liaison officers and rent office accommodation, their activities are curtailed with certain limits. A liaison, office cannot issue any invoices and cannot negotiate contracts with potential customers in a binding manner on behalf of its head office. As such, they are deemed as commercial activities and/or a materially internal element of a commercial activity.

Liaison offices are granted operation permits of three years at most. For extensions, successive extensions of a maximum of three years each may be granted by taking into consideration the activities of previous years and plans and objectives for the future. Liaison offices of banks are regulated by the Banking Regulation and Supervision Agency (BRSA) and are subject to special rules and reporting requirements determined by BRSA.

New Turkish Commercial Code

The New Turkish Commercial Code (the "New TCC") No. 6102 is enacted by the General Assembly of the Parliement on 13.02.2011 and published on the Official Gazette numbered 27846 dated 14.02.2011. It shall be entered into force on 01.07.2012. The New TCC redefines some important aspects of corporate life. Among these reforms the incorporation of a joint stock company (A) and the limited liability company (Ltd.) with a single shareholder or partner will be enabled, respectively. It will also, for the first time in Turkey, cover group companies, i.e. the relations between the parent company and subsidiaries which are subject to the same principles and policies and are gathered under the same group management. In order to ensure transparency, the Article 1524 of the New TCC requires each capital company to have an internet site and if such a site is already available, to render a certain part of it specific for information to stakeholders; however, the Article 1524 shall be entered into force one year later than effective date of the New TCC. Additionally, the auditing of the capital companies will be realized by the independent auditors as of the date 01.01.2013 in line with the Turkish Auditing Standards prepared in accordance with International Auditing Standards. In the meantime, all companies whether quoted in the stock exchange or not will be audited as of the date of 01.01.2013 in accordance with the Turkish Financial Reporting Standards as stipulated in the International Financial Reporting Standards. Joint stock companies will be allowed to hold online general assembly meetings. All administrative transactions of joint stock companies may be conducted online, which will create such options as online attendance for general assembly meetings, online submission of motions, online negotiations and online voting.

New Code of Obligations

The New Code of Obligations (the "New CoB") No. 6098 has been enacted by the General Assembly of the Parliamentary on 11.01.2011 and published in the Official Gazette numbered 27836, dated 04.02.2011. It shall be entered into force on 01.07.2012. Herewith the New CoB is being harmonised with EU law. Its innovations include regulations regarding the language simplification, the "pre-emption right" and a new provision under the heading of "Formation of Contract", which has been added under the section "Sources of Debt Relations", in the "General Provisions" of the Turkish Code of Obligations - Article 7, "Dispatch of Unordered Goods". The "Written Form and Signature" requirement regulated under the Articles 14 and 15 is made compliant with the Electronic Signature Law, No. 5070. The "participation in debt" by the third persons in Article 201, and the "transfer of contract" in Article 205 and the "joining in contract" on the side of either party thereto in Article 206 and "standardized terms of contract" regulated between the Articles 20 and 25 are new provisions which are not dealt with in the current Code of Obligations.

The Turkish Labour Code, Law No. 4857, regulates the employer-employee relationship in Turkey as individual parties.

Competition Law

The Turkish Competition Law, No. 4054, is envisaged to undergo significant changes, despite its being a relatively young law, published in December 1994 and amended in July 2005 and lastly in January 2008. The amendments made in January 2008 alter the calculation of administrative fines. In the meantime, a Draft on the Amendment of Turkish Competition Law is submitted for approval to the parliamentary on 31.07.2008. The proposed amendments aim to either facilitate or clarify the implementations of some provisions of the Competition Law and to be in harmony with EU Legislations. The draft amendment includes changes to merger control rules, powers of the Competition Board, exemption rules, the Board's right to ask for information, sight inspections, monetary fines and investigations.

Turkish Maritime Regulation in the New Turkish Commercial Code

The new regulation on the maritime law keeps sections (Ship-owner Ship, Vessel Master, Contracts for Maritime Commerce, Maritime Accidents, Maritime Liens, Limitation of Liability) in the same order as in the Maritime Book of the Turkish Commercial Code No. 6762, and adds a new section: Special Provisions on Compulsory Maritime Execution.

To facilitate the introduction of fundamental changes, the Commission chose to reorder the articles, a change that produced a new difficulty: recalling the new order of articles by those accustomed to the order in the 50 years old Maritime Book.

Turkish Labour Law

The Turkish Labour Code, Law No. 4857, regulates the employer-employee relationship in Turkey as individual parties. It regulates the conditions of the employment contract for which legal requirements are to be evidenced in writing if they are to be signed for a definite period of one year or longer. It also regulates the probationary period which shall be at most two months for employment contracts signed for a permanent period. During this period, the parties may terminate the employment contract without notice and compensation. The salary shall be paid to the employee once a month and a commission working under the Ministry of Labour and Social Security determines the minimum monthly gross wage to constitute a fair income level for the employees by taking into account the cost of living. As regards the termination of the employment contract, these may either be concluded for a definite or indefinite period of time, in the latter case both the employee and the employer are entitled to terminate the contract by observing the minimum periods stated in the Turkish Labour Code.

3. Tax Environment: Specificities

Corporate income, as adjusted for exemptions and deductions and including prior year losses (tax losses may be carried forward for five years but losses may not be carried back) is subject to corporate income tax at a rate of 20%, irrespective of the legal form (i.e. JSC, LLC, branch office).

Dividend distributions to individual and non-resident corporate shareholders are subject to withholding tax (WHT) at a rate of 15%. This rate may be reduced for foreign shareholders if a tax treaty is present. Please note that dividend distributions to resident entities and branches of non-resident entities are not subject to dividend WHT. For non-resident entities operating in Turkey (i.e. branches, other type of permanent establishments such as permanent representatives/agents) WHT will only be applicable on the portion of the profit that is transferred to the headquarters/principal, in other words repatriated from Turkey. The rate of WHT is 15% but can be reduced by a tax treaty.

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Tax Residency

According to Turkish tax legislation, corporate income taxation differs significantly based on the taxpayer's place of residence. If both the legal and the business headquarters of a company are located outside Turkey, the company is regarded as a non-resident entity. If either of them is located within Turkey, the company is regarded as a resident entity. Resident entities are subject to tax on their worldwide income, whereas non-resident entities are taxed solely on the income derived from activities in Turkey.

Corporate Tax System

Corporations are required to pay advance corporate income tax based on their quarterly profits at the rate of 20%. Advance corporate income taxes paid during the tax year are offset against the ultimate corporate income tax liability of the company, which is determined in the related year's corporate income tax return. The balance of advance tax can be refunded or used to offset other tax liabilities.

Tax Returns

Resident and non-resident entities having a permanent establishment in Turkey are obliged to file annual corporate income tax and quarterly advance corporate income tax returns (on a calendar year basis unless permission to the contrary is specifically obtained from the Ministry of Finance). The last date of submission of the corporate income tax return is the 25th of the fourth month following the fiscal year end. The advance tax return should be submitted at the latest by the 14th of the second month following the quarter period.

Payment of Tax

Corporate income tax must be paid by 30 April of the year of filing; taxable income is declared on a quarterly basis as advance tax on the 14th of the second month following each quarter, and is payable on the 17th of the same period. Advance corporate tax paid is offset against the final corporate tax calculated in the annual tax return.

Legal Reserves

Under the Turkish Commercial Code, Turkish companies are required to set aside first and second level legal reserves out of their profits. Please note that a branch is not subject to the legal reserve requirements.

Major Transaction Taxes

There are various transaction taxes in Turkey, as is the case in the other OECD member countries.

Value-Added Tax (VAT)

The Turkish tax system levies value added tax on the supply and the importation of goods and services. The Turkish name for Value Added Tax is 'Katma Deger Vergisi', abbreviated to KDV.

Liability for VAT arises:

a) When a person or entity performs commercial, industrial, agricultural or independent professional activities within Turkey; and

b) When goods or services are imported into Turkey.

VAT is levied at each stage of the production and the distribution process. Although liability for the tax falls on the person who supplies or imports the goods or services, the real burden of VAT is borne by the final consumer. This result is achieved by a tax-credit method where the computation of the VAT liability is based on the difference between the VAT liability of a person on his sales (output VAT) and the amount of VAT he has already paid on his purchases (input VAT).

Special Consumption Tax

There are four main product groups that are subject to special consumption tax at different tax rates:

- Petroleum products, natural gas, lubricating oil, solvents and derivatives of solvents
- Automobiles and other vehicles, motorcycles, planes, helicopters, yachts
- Tobacco and tobacco products, alcoholic beverages
- Luxury products

Unlike VAT, which is applied on each delivery, this tax is charged only once.

The last date of submission of the corporate income tax return is the 25th of the fourth month following the fiscal year end. The advance tax return should be submitted at the latest by the 14th of the second month following the quarter period.

Stamp tax rate on the taxable papers is 0.825%, with an exception that the lease agreements are taxed at 0.125%. Stamp tax is calculated on the highest value stated or calculable from the taxable paper or on the maximum amount stated on the paper. There is a cap of TRY 1,251,383.40 per agreement for 2011.

Banking and Insurance Transactions Tax (BITT)

The transactions being performed by licensed banks and insurance companies are generally exempt from VAT, but are subject to Banking and Insurance Transactions Tax (BITT) at a rate of 5%, which is due on the gains of such corporations from their transactions.

The purchase of goods and services by banks and insurance companies are subject to VAT, but this is considered an expense or cost item. Therefore it is not recoverable (i.e., for VAT purposes, by offsetting against the output VAT) in the hands of these corporations.

Property Taxes

Buildings and land owned in Turkey are subject to real estate tax at varying rates. Property tax is levied on the owner of real estate at 0.2% on buildings. If the buildings are used for residential purposes it is reduced to 0.1%. For newly constructed buildings, however this tax cannot be lower than the property tax of the land on which it is built. In a few cases, i.e retired citizens' domiciles, the tax rate is 0%. Also, the property tax rate for land is 0.1%, whereas the rate for arable is 0.3%. The rates are applied twice for property located in the metropolitan municipality areas. Property tax is payable annually in two installments in May and November.

Furthermore, a supplementary surcharge for Protection of Cultural Assets is levied amounting to 10% over the accrued property tax amount of the real estate. The surcharge is payable at the same time with the property tax.

Stamp Tax

Documents within the scope of stamp tax are papers which are legally valid and exercisable, bearing a signature (or a sign replacing signature, or electronic signature) and prepared for the purpose of proving any legal subject. In this sense, stamp tax applies to a wide range of documents including written agreements.

Stamp tax rate on the taxable papers is 0.825%, with an exception that the lease agreements are taxed at 0.125%. Stamp tax is calculated on the highest value stated or calculable from the taxable paper or on the maximum amount stated on the paper. There is a cap of TRY 1,251,383.40 per agreement for 2011.

Withholding Tax

Under the Turkish tax system, certain taxes are collected through withholding, for example in the hands of the service recipient tax-registered entities making the payments in Turkey in order to secure the collection of taxes. These include income tax on salaries of employees, lease payments to individual landlords, independent professional service fee payments to resident individuals; and royalty, license and service fee payments to non-residents. Companies in Turkey are responsible for withholding such taxes on their payments and declaring them through their Withholding Tax returns. However, please note that local Withholding Tax rates may be reduced or even the Turkish taxation may be eliminated based on the provisions stipulated in more than 70 effective bilateral tax treaties, where Turkey is a party.

Related Party Transactions

In principle, transactions between the related parties must be carried out on an arm's length basis. There are specific rules in this respect in Turkish tax legislation, as stated below.

Thin Capitalization

According to the thin capitalization regulation, if the ratio of the borrowings from shareholders or from persons related to the shareholders exceeds three times the shareholders' equity of the borrower company at any time within the relevant year, the exceeding portion of the borrowing will be considered as thin capital. Excluding loans received from credit institutions that provide loans only to their related companies, the loans received from related banks and similar institutions alone will not be considered thin capital until the amount of the borrowing exceeds 6 times the shareholders' equity.

In addition to the interest paid or accrued, foreign exchange losses and other similar expenses calculated over the loans that are considered as thin capital are treated as non-deductible for corporate income tax purposes. The interest paid or accrued and similar payments on thin capital are reclassified at the end of the relevant fiscal year as dividend distributed from the perspective of the borrower and as dividend received from the perspective of the lender, and as repatriated profit for non-resident taxpayers.

Transfer Pricing

Corporate income tax law includes transfer pricing regulations which are adopted from the OECD's guidelines. If a taxpayer enters into transactions regarding the sale or purchase of goods and services with related parties, in which prices are not set in accordance with the arm's length principle, the related profits are considered to be distributed in a disguised manner through transfer pricing. Such disguised profit distributions through transfer pricing are not accepted as tax-deductible for corporate income tax purposes. The methods prescribed in the law are the traditional transaction methods described in the OECD's transfer pricing guidelines.

Anti-Tax Haven Provisions

All sorts of payments made to corporations (including branches of resident corporations) that are established or operational in countries which are regarded by the Turkish Council of Ministers to undermine fair tax competition due to tax and other practices, may be subject to taxation in Turkey at a rate of 30% irrespective of whether the payments in question are subject to tax or not, or the corporation receiving the payment is a taxpayer or not. However, there are certain exemptions. Moreover, as of today, the Turkish Council of Ministers has not yet determined which countries receiving payments shall be considered as 'tax havens'.

Treatment of Group Entities

Consolidation of the accounts of group companies' entities for tax purposes is not allowed in Turkey, since each company entity is regarded as a separate taxpayer unit for tax purposes in Turkey.

Controlled Foreign Corporation Rules

Corporations established abroad and controlled directly orindirectly 50% or more by tax-resident companies and real persons by means of separate or joint participation in the capital or dividends or voting rights are considered to be CFCs, provided that some conditions are fulfilled i.e. 25% or more of the gross revenue of the foreign subsidiary must be composed of passive income and The CFC must be subject to an effective income tax rate lower than 10% for its commercial profit in its home country etc.

The CFC's prorated profit would be included in the corporate income tax base of the controlling resident corporation at the rate of the shares controlled, irrespective of whether it is distributed or not, in the fiscal period covering the month of closing of the according of CFC. The CFC's profit that has already been taxed in Turkey as per this article will not be subject to additional tax in Turkey in the event of dividend distribution; whereas the portion of the profit distributed that had not been previously taxed in Turkey will be subject to taxation.

In the last decade, Turkish Parliament has enacted several incentive regulations for research and development (R&D) activities in Turkey.

Holding Regime in Turkey

There is an unconditional corporate tax and dividend withholding tax exemption for dividend income between Turkish companies. If a Turkish company has a shareholding in a foreign company this dividend income is exempt from corporate tax under certain conditions.

For capital gains generated from share sale in a Turkish company by another Turkish company, 75% corporate tax exemption is applicable under certain conditions. In the event a foreign subsidiary is sold by a Turkish company, under certain conditions 100% corporate tax exemption is applicable.

Recent Significant Developments

Research and development (R&D) activities

In the last decade, Turkish Parliament has enacted several incentive regulations for research and development (R&D) activities in Turkey.

On April 2008, a new R&D Law was enacted to broaden incentives for R&D activities. The R&D Law enables companies resident in Turkey and non-resident companies with a subsidiary or branch in Turkey to benefit from R&D tax incentives if the companies have an R&D centre licence from the Ministry of Industry and Trade or are involved in R&D and innovation projects supported by governmental institutions, foundations established by law or international funds.

Incentives introduced by the R&D Law are:

- ***R&D deduction:*** All eligible innovation and R&D expenditures made in R&D centres (which must employ at least 50 full-time equivalent R&D personnel), R&D and innovation projects supported by governmental institutions, foundations established by law or international funds can be deducted from the corporate income tax base at a rate of 100%. The same expenditure can also be capitalised and expensed through amortisation over five years in the case of successful projects, while failed projects' R&D expenditures can be expensed immediately.
- ***Income tax exemption:*** 80% of the salary income of eligible R&D and support personnel (max. 10% of the number of full-time R&D personnel) is exempt from income tax. Moreover, this rate is increased to 90% for personnel with a Ph.D.
- ***Social security premium support:*** Half the employer portion of social security premiums for R&D and support personnel (max. 10% of number of full time R&Dpersonnel) will be funded by the Ministry of Finance for five years.

- ***Stamp tax exemption:*** Documents prepared in relation to R&D activities are exempt from stamp duty.

  There are also significant advantages to investors planning R&D activities in science, software and technology in special zones known as 'techno-parks'.

  Incentives provided for companies in technoparks are:

- ***Corporate income tax exemption:*** The profits derived from the software or products developed as a result of the research and development activities in technoparks are exempt from corporate income tax until 31 December 2023.

- ***Income tax exemption:*** The salaries of researchers, software developers and research and development personnel in technoparks are exempt from income tax until 31 December 2023.

- ***Social security premium support:*** Half the employer portion of social security premiums for researchers, software developers and research and development personnel in technoparks will be funded by the Ministry of Finance for five years until 31 December 2023.

- ***VAT exemption:*** Deliveries of software (specifically on system management, data management, business applications, internet, mobile and sector applications, military command control applications) produced by companies operating in technoparks are exempt from VAT until 31 December 2023.

E-invoicing

'E-invoicing' is the general term given to invoices presented as electronic documents, the exchange of which between parties is made in a secure and careful manner.

The e-invoice is not a brand new document with additional legal features, rather it possesses the same legal features of a printed invoice. The general application of e-invoicing among all companies is envisioned. The Revenue Administration registers user accounts for companies with approved e-invoice applications.

It is only possible to issue e-invoices to registered users willing to receive e-invoices. If they request a printed invoice, a company is required to provide the counterparty with a printed invoice rather than an e-invoice.

PwC Turkey

PwC firms provide industry-focused assurance, tax and advisory services to enhance value for their clients. More than 169,000 people in 158 countries in firms across the PwC network share their thinking, experience and solutions to develop fresh perspectives and practical advice.

PwC operating in Turkey since 1981, consists of 5 offices; in Istanbul (2), in Ankara, in Bursa and in Izmir, with 1,250 professional staff.

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