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# Doing Business in Turkey

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# Contents



# 1. Turkish market overview

The Turkish economy, the 17th largest economy in the world (in PPP terms), grew at a rapid rate, except during the local 2001 crisis and the 2008 and 2009 global crises. The realized CAGR (Compound Average Growth Rate) was 4.2% over that of the last decade.

This can be interpreted as the reward for the solid macro policies that have been pursued since 2001. The size of the Turkish economy (GDP) as of the 2014 year-end was 799 billion USD and the per capita GDP was 10,390USD. The general consensus indicates that Turkey's projected economic growth rate is around 4.5-5.5% per annum, in the medium term.

Due to its strong fundamentals, demographic structure, and great potential, inflows of Foreign Direct Investment (FDI) to Turkey continue. In addition, Turkey attracted an average of 12 billion USD in real-estate investments each year between 2009 and 2014.

For more than 5 years Turkey has met two of the Maastricht Criterion, namely public debt/GDP and budget balance/GDP, whereas even Eurozone members could not achieve such success. Its two weakest points are inflation and current account deficit; however, officials have been taking measures to cope with this.

For instance, the inflation targeting regime, which has been implemented explicitly since 2006, resulted in a drop in inflation rates, which were around 68.5% in 2001, to single digit levels. Balance of payments figures are expected to decline with incentives and policies aimed at raising savings within the country.

Based on the investment grade Turkey attained from two of three rating agencies (Moody's, and Fitch), the country is projected to become the interest of an increased foreign investor base. Also, comparably higher capital inflow potential with longer maturity and lower costs will help the country's macro dynamics improve more.

According to PwC's estimates, Turkey's total GDP is forecasted to move up to the 14th rank in the global league rankings for 2030, and is expected to maintain that rank until 2050.


***Turkey has the opportunity to capitalise on a growing, skilled labour force to sustain long-term economic growth. The range of options that are open to Turkey should allow it to catch up to its European peers by 2050, cementing itself in the 14th position as early as 2030.***

## *1.1. Turkey's key attractions*

- Turkey is close to Europe (just a two to three hour flight to major European destinations), the Middle East, and the Caucasus. As a bridge between Europe and Asia, Turkey benefits from its location. It 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 resulted in the expansion of trade relations with Europe, which now account for around 40% of Turkey's 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 million people, 47% of which are younger than 30 years old.
- 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 which offer incentives such as free land and energy support. Investors can also benefit from R&D support with the aim of encouraging exports and increasing the competitiveness of firms in international markets.
- The Turkish government also introduced flexible exchange rate policies and liberal import regulations in order to promote and sustain foreign investment.


- In recent years, Turkish banks took on an increasingly larger role in financing project deals, which benefit from increasingly liquid balance sheets in many cases.
- The Turkish legal framework offers a level playing field to domestic companies. Foreign ownership is unrestricted, with no pre-entry screening requirements.
- New Commercial Code No. 6102 came into effect as of July 2012. It aims to integrate local applications with EU law, improve transparency, protect minority rights, and strengthen corporate governance principles.

## 1.2. The future path for growth

### Young and educated labour market

Turkey's demographics have the potential to support a solid economic growth path. By 2050, Turkey's population is expected to grow by around 26%, to approximately 94 million. Turkey's population will also be relatively young and well-educated. In 2050, 57% of Turkey's population is expected to be of working age (15-59).

### Adding more value

Positive developments in the labour market could support a gradual move towards higher value-added industries, potentially allowing a number of centres of excellence to take shape in Turkey. The government can play an important role in supporting these developments. A number of government reforms already aim to facilitate the transition with an R&D incentive programme offering generous tax breaks, loans, and grants to support firms competing higher up the value chain. The privatisation of energy, utility, and infrastructure sectors would encourage efficiency and increase productivity.

## 1.3. Turning challenges into opportunities

### Risks to overcome

If Turkey is to reach its full potential, as highlighted in the projections presented above, then there are major economic challenges to be overcome. For example, the current structure of the economy remains susceptible to potential bouts of inflation, with required monetary tightening often hurting exports most. The economy would benefit from a greater focus on exports and on raising savings to reduce the persistent current account deficit.

The huge current account deficit (CAD) in Turkey has been driven by rapidly rising private consumption and declining savings. Turkish authorities implemented measures such as incentives for savings and consumption curving measures so as to reduce external vulnerabilities. These latest policy measures are intended to increase the structurally low savings rate and are expected to have a positive effect on the CAD.

With the latest local and global developments, the CAD to GDP ratio dropped from the 2011 rate of 9.7% of GDP to 5.7% of GDP in 2014.

### Structural reforms key

As Turkey moves towards higher value industries, structural reforms are expected to become increasingly important in order to improve competitiveness vis-a-vis other economies. Improving the transport infrastructure, the legal framework, and tax collection efficiency could be some of the items with higher priority on the government's agenda in order to foster sustainable growth over the longer term.

# 2. Legal environment: specificities

According to Foreign Direct Investment Law No. 4875, foreign investors are entitled to establish joint stock companies, limited liability companies, and branches in Turkey, in line with Turkish Commercial Code No. 6102. Foreign investors are also allowed to incorporate liaison offices, which are preferred as another vehicle to enter the Turkish market, as per the provisions of the law.

## 2.1. Introduction

The principals for encouraging foreign direct investment in Turkey are mainly regulated under Foreign Direct Investment Law No. 4875 ("Law No. 4875"), which defines the foreign investor as a company/legal entity registered outside of Turkey, a non-Turkish national, or a Turkish national residing abroad who is entitled to form a commercial company in Turkey.

Within the scope of Law No. 4875, foreign investors are entitled to establish any kind of legal entities, which are stipulated under Turkish commercial legislation. The main legislation regulating Turkey-based legal entities, and the corporate law principles in that respect, is Turkish Commercial Code No. 6102 ("TCC",) which entered into force on 1 July 2012. The TCC will also be applicable to those foreign capitalized companies who seek to establish themselves in Turkey.

In line with the foregoing, there are several types of entities that can be set up under Turkish legislation. As per the provisions of the TCC, companies can either be set up in the form of a joint stock company ("JSC") or a limited liability company ("LLC"), as well as in the form of a branch office ("Branch"). Furthermore, foreign investors can also incorporate a liaison office ("Liaison Office") in Turkey so as to enter into the Turkish market as per the provisions of Law No. 4875 and Regulation on the Implementation of Foreign Direct Investment Law.

## *2.2. Main characteristics of JSC, LLC, Branch, and Liaison Office*

The main characteristics of a JSC, an LLC, and a Branch, and brief information on liaison offices, are briefly set out below:

### *JSC and LLC*

The most common company types under the TCC are JSC and LLC, which are subject to the same establishment procedures in Turkey before the relevant authorities. However, these companies slightly differ in terms of their main characteristics.

To begin with, the TCC foresees different minimum capital requirements and a minimum nominal value of shares for JSC and LLC. Accordingly, the minimum capital requirement for JSC is 50,000TRY, while a LLC can be established with a minimum capital of 10,000TRY. Furthermore, the capital of JSC has to be divided into shares, each with a minimum nominal value of 0.01TRY. The capital of a LLC has to be divided into shares, each with a minimum nominal value of 25TRY, or multiples of this amount. Additionally, a JSC is allowed to issue debentures and offer its shares to the public whereas a LLC is prohibited from issuing debentures and cannot offer its shares to the public.

Another main distinction between a JSC and a LLC is related to the liabilities of the shareholders of the referred companies. As per the relevant legislation, shareholders of a JSC are not personally liable for the debts of the company. However, shareholders of a LLC are liable for the public debts of their company in case such public debts are not covered by the company itself.

Moreover, a JSC and a LLC have different management and representation organs. Within this framework, while a JSC is managed and represented by a board of directors, which may be composed of at least of one member, a LLC is managed and represented by a manager or board of managers.

Another main difference between a JSC and a LLC concerns their fields of activity. Based on this, a JSC may be incorporated for all kinds of economic purposes and scopes that are not prohibited by law. A LLC may be incorporated for all kinds of economic purposes and scopes that are not prohibited by law; however, prohibited from operating in banking, insurance, and other specific sectors. Such specific sectors require companies to be established as joint stock companies in order to grant specific licenses or commence their activities.

Despite their differences, it must be highlighted that both a JSC and a LLC can be incorporated with a minimum of one shareholder, who can be either an individual or a legal entity. Additionally, according to the TCC, the ultimate decision-making organ of both a JSC and a LLC is the general assembly.

### *Branch*

Foreign investors are also entitled to establish a Branch in Turkey in order to engage in activities within Turkey, as per the TCC and the Trade Registry Regulation. Different than a JSC and a LLC, Branches may be incorporated only for the same purposes as the parent company. In this respect, branches shall not have separate Articles of Association and consequently shall merely act within the fields of activity of their parent company.

It should be highlighted that there is no minimum capital requirement for branches. That being said, branches may have separate capital which may be allocated by the parent company. In practice, it is generally preferred by the parent companies to allocate capital to their branches.

Furthermore, branches are managed by the parent company and represented by the branch manager(s) before third parties who is/are appointed by the parent company. Turkish citizens and foreigners can be appointed as branch managers; however, it is required that they reside in Turkey.

## *Liaison office*

There also exists a Liaison Office structure in Turkey, which is considered neither a capital company nor a branch, but which is preferred by foreign investors as a practical way to enter the Turkish market. Basically, foreign capitalized entities may likely prefer to be established as a Liaison Office in Turkey so as to represent parent companies' business activities and to gather necessary information on the related sector and the country on behalf of the parent company.

The terms and conditions of establishing a Liaison Offices in Turkey are regulated under Law No. 4875 and the Regulation on the Implementation of Foreign Direct Investment Law. As per such legislation, establishment of a Liaison Office is subject to the permission of the Ministry of Economy. Furthermore, Liaison Offices are prohibited from engaging in commercial activities and conducting any income-generating activity in Turkey. Due to this, all payments that result from the daily activities of Liaison Offices are to be covered by their parent companies. It is also of importance to state that there exists no foreign capital requirement in establishing a liaison office.

As mentioned, a Liaison Office is a business type which is not allowed to conduct "commercial activities" but is allowed to carry out the activities indicated under the Regulation on the Implementation of Foreign Direct Investment Law. These activities are as follows:

- Market research
- Promotion of the goods and services of the parent company
- Representation and hosting
- Control of the suppliers in Turkey in terms of quality and standard, their supervision, and supplier procurement
- Technical support
- Communication and information transfer
- Regional management center
- Other

In case the field of activity of the parent company is related to specific legislative sectors such as insurance, banking, and capital markets, the application on the establishment of a liaison office is also considered by the relevant governmental authority.

Liaison offices in Turkey are represented by a liaison office representative who will be empowered by the parent company through a power of attorney. The representative may either be a Turkish citizen or a foreigner.

The establishment permit can be granted by the Ministry of Economy for up to a period of 3 years and can be extended after expiration. However, the activity period of the Liaison Offices, which are established to engage in activities on market research and promotion of parent company products or services, cannot be extended and the Ministry of Economy has the right to terminate the establishment permit of a liaison office whenever any kind of breach of legislation is ascertained.

Furthermore, Liaison Offices are required to submit an annual report to the Ministry regarding their previous years' activities until the end of May of each relevant year, at the latest.

Foreign investors are also authorized to establish a regional management center in the form of a liaison office, thus gaining certain advantages. Those types of regional management centers are preferred for the purpose of organizing management and coordination on following exemplified activities of the parent company's various units in different countries within the determined region: forming investment and management strategies, planning, promotion, sales & post-sales services, brand management, technical support, research and development, external supply, testing the newly developed products, laboratory services, research analysis, training and education of employees.

# 3. Employment

## 3.1. Introduction

The principal law governing the employer-employee relationship in Turkey for individual parties is Turkish Labour Law No. 4857. The Turkish Labour Law is applicable to all workplaces, other than those specified in the mentioned law, to their employers and employers' representatives, and to the employees of the said workplaces, regardless of their activities.

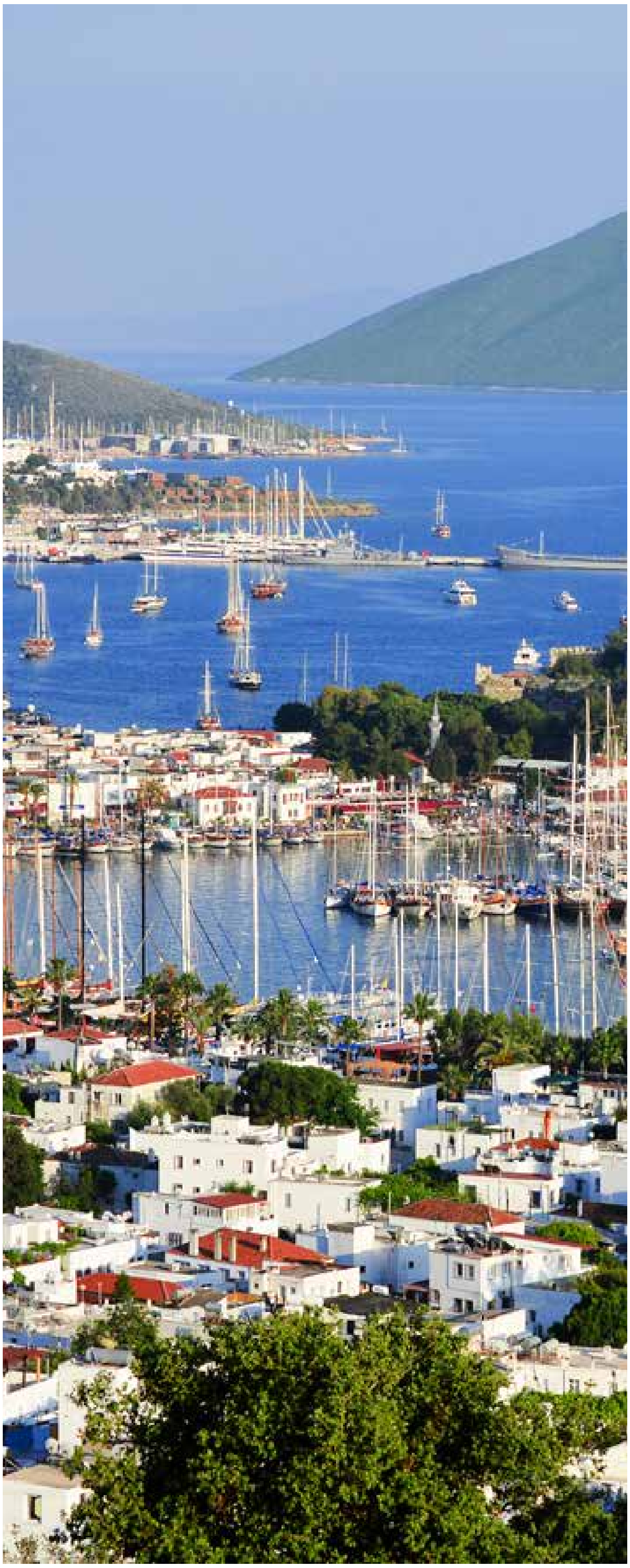
The main institution involved with employment issues is the Ministry of Employment and Social Security Affairs. Labour disputes are handled by specialized courts called Labour Courts. The Turkish Labour Law sets forth provisions both for individual and collective employment and indicates key factors of employment, such as:

***Individual employment regulations***

- Employment contract
- Working time
- Salary
- Holidays
- Military service
- Maternity leave and other leave provisions
- Equality
- Termination of employment

***Collective employment regulations***

- Trade unions
- Collective bargaining agreements
- Collective dismissals



## 3.2. Foreign employees in Turkey

An efficient structure for talent mobility is a key element of sustainable growth and success for any multinational company.

Turkey hosts a large number of expatriates who bring a wide range of expertise to different industries. Linked with the continuous need to move select individuals from their talent pool swiftly across borders is the essential need for companies to stay compliant with local rules and continue to update their understanding of heightened scrutiny from immigration, tax, and social security authorities.

### Key considerations

#### 1. Immigration requirements

Foreign national individuals to be employed in Turkey need a work visa and a work permit in order to be eligible to work and reside in Turkey.

The first step to obtain authorization to work in Turkey is applying for a work visa through the Turkish representative (consulate/embassy) in the individual's country of residence or citizenship. Within 10 days following the work visa application, a work permit application must be filed with the Ministry of Labor by the Turkish employer (or the sponsoring entity). After the work permit is issued, the employee should visit the Turkish Representative, with whom the work permit application was filed, and obtain the work visa. Authorities must be informed of the individual's Turkish residence address within 20 days of entrance into Turkey.

Foreign nationals holding valid Turkish residence permits (a minimum validity of 6 months is required) do not need a work visa prior to applying for a work permit.

Response to work permit applications is received within one month, once the documents are submitted to the Ministry of Labor. The overall process, including completion of the application documents and the work visa application, may take up to 2-3 months.

Professional services such as engineering, city planning, and architecture are carefully regulated, therefore work permit applications for foreign nationals holding one of these degrees differ from regular work permit applications, and may take up to a year.

In case of such applications, individuals may be granted pre-approval to work for one year, provided that they do not perform any technical duties within that one year period.

#### 2. Income tax

If the employee's salary is either directly or indirectly paid by the local employer, income tax is withheld every month from salary paid through Turkish payroll under the pay-as-you-earn (PAYE) system. The employer's withholding obligations, the filing time of the monthly withholding tax returns, and payment of taxes are no different than for regular Turkish employees.

Depending on the foreign employee's residency status in Turkey, any employment income that is taxable in Turkey and is not captured on the individual's local payroll would, in principle, trigger an individual income tax return filing requirement.

Split pay arrangements should be further analyzed based on this understanding.

#### 3. Social security tax

A foreign national who is covered under the compulsory social security system of his/her home country (which has a social security agreement in force with Turkey, or is a party to the European Convention on Social Security) is not required to pay Turkish social security premiums, provided a certificate of coverage is filed with the local social security office. If the individual is assigned to Turkey from a country which does not have a social security agreement with Turkey, there may still be a 3-month exemption, if certain documentation requirements are satisfied. If the employee is not subject to foreign social security, full contributions are generally imposed.

# 4. Tax environment: specificities

## 4.1. High level introduction, to Turkish taxation

The primary tax considerations that arise in Turkey include corporate income tax, withholding tax (on the repatriation of profits), and indirect taxes, including customs duties (on import).

There are also significant transfer pricing risks associated with related party transactions and it will be necessary to ensure that related party transactions, i.e. sales charges, are undertaken on an arm's length basis.

In Turkey, there is no single registration, i.e. for VAT (Value Added Tax) or other taxes purposes. Once a company registers for tax purposes, it will be liable for all Turkish taxes, i.e. CIT(Corporate Income Tax), VAT, withholding tax, stamp tax, etc.

### *Direct tax:*

Corporate income, as adjusted for exemptions and deductions, 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). Likewise, branch profits are subjected to the Turkish CIT at a rate of 20% since branches are taxed solely on the income derived from activities in Turkey, because they are regarded as non-resident entities from Turkish tax perspective.

### *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 the salaries of employees, lease payments to individual landlords, independent professional service fee payments to resident individuals, royalty, license, and service fee payments to nonresidents. 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 the Turkish taxation may even be eliminated based on the provisions stipulated in more than 80 effective bilateral tax treaties to which Turkey is a party.

Dividend distributions to individual and non-resident corporate shareholders are subject to the 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 the dividend WHT. For non-resident entities operating in Turkey (i.e. branches, other types of permanent establishments such as permanent representatives/agents) the 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 the WHT is 15% but can be reduced by a tax treaty.

### *Indirect tax:*

Goods imported by the newly incorporated company with a certificate of origin from the EU will not attract a customs duty. If the payment related to the import is not made before the actual importation, then it is subject to a RUSF of 6%. A VAT of 18% will be levied on imports and domestic sales. In addition, services received from non¬resident companies will be subjected to reverse charge VAT at a rate of 18%.

### *Payroll taxes:*

Payroll payments (salary payments to employees) necessitate income tax, social security premiums, and stamp tax on gross payments to employees. Income tax brackets are announced at the beginning of each year by the Ministry of Finance. The income tax withheld at the source is to be declared with the withholding tax return filed by the company for that related period. Please find the brackets announced for 2015 below:

| *Taxable income over* | *Not over* | *Tax on lower amount* | *Percentage on excess* |
|---|---|---|---|
| *0* | *12.000* | *0* | *15%* |
| *12.000* | *29.000* | *1,800* | *20%* |
| *29.000* | *66.000* | *5,200* | *27%* |
| *106.000* | *And above* | *25,990* | *35%* |

Stamp tax is levied on gross wages at a fixed rate of 0.759% for 2015. Social security premiums and unemployment premiums should be declared by employers on a monthly basis. Employee contributions are deductible when determining taxable income. Employees pay 14% and employers pay 20.5% per month for earnings up to 7,809.90TRY, between 1 January 2015 and 30 June 2015 and up to 8,277.90TRY between 1 July 2015 and 31December 2015.

As regulated in Article 24 of Law No. 5763, the Treasury will be financing 5% of the companies' social security employer costs, which means that the total social security contribution will be 32.5% instead of 37.5%, and the employer's share will decrease from 22.5% to 17.5%. In order to benefit from 5% treasury support, the following conditions should be met:

- Retired employees cannot benefit from the provisions of this new regulation.
- In order to benefit from the treasury support, the company should have no debt to the Social Security Institution.

### *Stamp taxes:*

Stamp tax applies to a wide range of documents, including, but not limited to, agreements, financial statements, and payrolls. Stamp tax is levied as a percentage of the value stated on the agreements at rates varying between 0.189% and 0.948% for 2015. The maximum payable stamp tax amount is 1,702 million TRY over each original copy.

### *Resource Utilization Support Fund (RUSF) on foreign sourced loans:*

Foreign sourced loans obtained by Turkish resident individuals or legal entities (except for banks or financial institutions) are subject to RUSF at a rate of:

- 3% on the principal if the average maturity period of the foreign currency denominated loan does not exceed 1 year
- 1% on the principal if the average maturity period of the foreign currency denominated loan is between 1 and 2 years (including 1 year)
- 0.5% on the principal if the average maturity period of the foreign currency denominated loan is between 2 and 3 years (including 2 years)
- 0% on the principal if the average maturity period of the foreign currency denominated loan is longer than 3 years (including 3 years)

Please also note that any foreign sourced TRY denominated loans would attract a RUSF over interest payments at 3%, regardless of maturity.

### *Property taxes:*

Property taxes should not apply unless real property in Turkey is purchased. Please refer to the related section for further details regarding property taxes.

### *Taxes on incorporation:*

There is a competition fund payable over capital contributions at 0.04%. No other direct or indirect taxes applicable to capital are incurred on a yearly basis.

## 4.2. Corporate tax

Corporations are required to pay advance corporate income tax based on their quarterly profits at a 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.

### *Typical calculation of corporate income tax is as follows:*

The corporate income tax base is calculated by adjusting the commercial profit with deductions and non-deductible expenses.

### *Typical deductible expenses are as follows:*

Expenses incurred for the issuance of share certificates or corporate bonds.

Start-up costs (these costs are either to be expensed or capitalised at the discretion of the tax payer).

Previous years' tax losses provided that they have not been carried forward for more than five years (on the condition that the tax loss corresponding to each year is specified in the corporate income tax return. Please note that "deductible loss" is the "tax loss" for the previous five periods shown on the corporate tax return, not the "accounting loss" shown on the income statement or the balance sheet of a company). It is also worth mentioning that loss carryback is not allowed.

Donations made to governmental institutions or to associations and foundations which are granted tax exemption by the Council of Ministers, and which do not exceed 5% of the current year's profit.

All donations made for the construction of dormitories, nursery schools, rest homes, and rehabilitation centres, subject to certain conditions.

All cultural and artistic donations made to governmental institutions or to associations and foundations that are granted tax exemption by the Council of Ministers (such donations are cited in detail in the legislation).

All sponsorship payments for amateur sport activities and 50% of the sponsorship payments for professional sport activities.

***Depreciation of fixed assets***

Meals provided on the company's premises to employees, without any limitations. However, there is an updated limit each year.

***Social security contributions***

Compensation paid or losses incurred in line with contracts or court rulings, provided that they are related to the business.

Travel and accommodation expenses related to operations and proportional to the volume of business.

Real estate, stamp, and municipality taxes and duties and fees that are relevant to the corporation.

***Fees paid by the employer to labour unions***

Contributions paid by the employer to the private pension system (subject to a ceiling).

### *Typical disallowable expenses are as follows:*

- Interest, foreign exchange losses, and other financial expenses on capital and on loans which are regarded as thin capital;
- Fines and penalties and other indemnities arising from the wrongdoing of the taxpayer;
- Donations to foundations (that are granted a tax exemption by the Council of Ministers), or to government institutions exceeding 5% of corporate profit;
- Expenses recorded through severance pay provisions (severance pay shall be accepted as tax deductible only when actual payments are made to employees); and,
- The portion of expenses incurred that is considered in violation of transfer pricing regulations.

### *Tax returns*

Resident and non-resident entities that have 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 end of 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.

### *Bookkeeping in Turkey*

Article 182 of the Tax Procedures Law itemises the legal books that should be maintained by companies that

keep their records per the balance-sheet method. These are:

- Journal ledger
- General ledger
- Inventory ledger

In addition to the above ledgers, the Turkish Commercial Code requires the maintenance of the following books:

- Resolution book (Joint Stock Companies)
- Managers resolution book (Limited Liability Companies)
- Share ledger
- General assembly and negotiation book

These legal books should be certified by a public notary before the commencement of the new accounting year. In general counting year is deemed as a calendar year but a different fiscal year is acceptable if approved by the Ministry of Finance.

The company's accounting can be performed by a shared service center located abroad and the electronic server can also be located outside Turkey, bearing in mind that all original documents and records should be made available in case of an inspection or upon any statutory request.

It is mandatory that the legal books be kept in the local language, in terms of the Turkish Lira, and in line with the Turkish Uniform Chart of Account; however, dual language records are allowed. Legal books should be printed as hardcopies if the company is not registered with e-invoicing and/or e-bookkeeping systems.

### *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. Paid advance corporate tax 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 from their profits. Please note that branches are not subject to the legal reserve requirements.

## *4.3. Major transaction taxes*

### *Value Added Tax (VAT)*

Any person or entity engaged in an activity within the scope of the VAT law must notify the local tax office where his place of business is located. Please note that there is no single "VAT registration" approach in Turkey because it is not possible to register only for VAT purposes in Turkey. In order to register for VAT purposes, a foreign company must have a permanent establishment (PE) in Turkey and is obliged to register for all tax purposes (i.e. VAT, corporate income tax, withholding tax, stamp duty, etc.) with a tax office in Turkey.

### *The VAT rates*

The Turkish VAT system employs multiple rates and the Council of Ministers is authorized to change the VAT rates within certain limits.

The standard rate of the VAT on taxable transactions is set at 10% in the VAT Law, but this rate was increased to 18% on 15 May 2001.

For the deliveries and services mentioned in List No. 1, e.g., agricultural products such as raw cotton, dried hazelnuts, etc., the rate is 1%. For the deliveries and services mentioned in List No. 2, e.g., basic food stuffs, books, and similar publications, the rate is 8%.

Please note that there are two basic forms of exemption under the Turkish VAT law:

**1- Exemption without credit for previously paid VAT**

In this case, input VAT cannot be deducted or reclaimed but can only be recorded as a cost or an expense. Transactions subject to "exemption without credit for previously paid VAT" include the supply of goods and services for cultural, educational, recreational, scientific, social, and military purposes and certain other categories.

**2- Exemption with credit for previously paid VAT**

In this case, transactions are exempt from VAT but the taxpayer has the right to offset or request a refund of previously incurred VAT. This mechanism is principally concerned with export operations.

### *Special Consumption Tax (SCT)*

The special consumption tax is a tax applied to manufacturing, importation and first acquisition of a range of goods. SCT is applied one time only, unlike VAT. Four main product lists fall within the scope of SCT. They are:

- petroleum products, natural gas, lubricating oil, etc. – List 1
- automobiles, motorcycles, planes, other vehicles, etc. – List 2
- tobacco and tobacco products, alcoholic beverages, etc. - List 3
- luxury products such as diamonds, cellular phones,etc. - List 4

### *Banking and Insurance Transactions Tax (BITT)*

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

The purchase of goods and services by banks and insurance companies are subjected to the 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 metropolitan municipality areas. Property tax is payable annually, in two installments, in May and November.

Furthermore, a supplementary surcharge for the protection of cultural assets is levied at an amount of 10% over the accrued property tax amount of the real estate. The surcharge is payable at the same time as the property tax.

### *Stamp Tax*

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

The stamp tax rate on the taxable papers is 0.948%, with an exception for lease agreements which are taxed at 0.189%. The 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 1,702,138.00TRY, per agreement, for 2015.

## *4.4. Related party transactions*

Transfer pricing provisions set forth in Article 13 of Corporate Tax Law No. 5520, and effective as of 01 January 2007, were prepared taking into consideration the OECD Transfer Pricing Guidelines and international developments.

### *Arm's length principle*

Under the arm's length principle, with the new legislation, related parties must set the transfer prices for the purchase and sale of goods and services as they would have been agreed upon between unrelated parties.

The term "related party" is defined in a very broad manner in the legislation and covers any group company with direct or indirect shareholding, without any limitation, and also with direct or indirect control. The term "related party" also covers those with whom the company has continuous economic relations, which directly or indirectly affect the economic and commercial decisions of that company.

### *Documentation requirements*

Taxpayers should submit the form "Transfer Pricing, Controlled Foreign Corporations, and Thin Capitalization" as an attachment to the annual corporate tax return.

Taxpayers are obliged to prepare an annual TP report, the scope of which changes according to the following criteria:

i. Corporate taxpayers registered with the Large Taxpayers Tax Office should prepare a report for both cross-border and domestic related party transactions. They should also include the transactions with their related parties operating in Turkish free trade zones.

ii. Other corporate taxpayers should prepare a report only for their cross-border related party transactions. They should also include the transactions with their related parties operating in Turkish free trade zones.

iii. Corporate taxpayers operating in Turkish free trade zones should prepare a report for the transactions with their Turkish resident related parties.

Annual transfer pricing reports should be prepared by the deadline for filing the annual corporate tax return. However the reports shall be presented when requested by the Turkish Revenue Administration or by those persons authorised to carry out tax inspections. When an annual transfer pricing report is requested, the report should be presented within 15 days, as per the general provisions of the Tax Procedural Law.

### *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 thin capital. Excluding loans received from credit institutions which provide loans only to their related companies, the loans received from related banks and similar institutions alone will not be considered as 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.

## *4.5. Participation exemption regime in Turkey*

There is an unconditional corporate tax and dividend withholding tax exemption for dividend income between Turkish companies. If a Turkish company owns shares of a foreign company, this dividend income is exempt from corporate tax under certain conditions.

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

## *4.6. Other tax-related issues*

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 as undermining 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 the corporation receiving the payment is a taxpayer. However, there are certain exemptions.

Moreover, as of today, the Turkish Council of Ministers has not yet determined which of the 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.

### *Controlled Foreign Corporation rules (CFC)*

Corporations established abroad and controlled directly or indirectly, 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 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 subjected 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 CFC. The CFC's profit which 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.

# 5. Incentives

## 5.1. Investment incentives

The Turkish government provides investment incentives - so-called state aid - in order to eliminate inter-regional economic imbalances, facilitate a larger capital contribution to the country's capital build-up by public and foreign investors, and support activities that have a positive effect on employment.

Under the Investment Incentive System, investments have been divided into five main categories:

- General investments
- Regional investments
- Preferential investments
- Large Scale investments
- Strategic investments.

In the scope of the Investment Incentive Certificate (IIC), companies can benefit from the following ten components:

### State aid elements for investments

- VAT exemption
- customs duty exemption
- RUSF exemption
- corporate tax support
- support for employer portions of social security premiums
- land allocation
- interest support
- VAT refund
- support for salary income taxes (only for investments realised in region 6)
- support for employee portions of salary social security premiums(only for investments realised in region 6)

## 5.2. Incentives and support for R&D activities

### Current incentives

Tax incentives and support mechanisms that are provided to companies carrying out R&D and innovation activities in Turkey are as follows:

1. **Law No. 5520 on corporate income tax**

*R&D deduction (100%)*

All eligible innovation and R&D expenditures made for R&D and innovation projects which have been approved by the Ministry of Finance can be deducted from the corporate income tax base as an R&D deduction of 100%.

2. **Law No. 5746 on support of R&D activities**

*R&D deduction (100%)*

All eligible innovation and R&D expenditures made for technology centres, R&D centres (which must employ at least 30 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%.

*Income tax exemption (80-90%)*

80% of the salary of eligible R&D and support personnel (a maximum of 10% of the number of full time R&D personnel) is exempt from income tax. This rate increases to 90% for personnel with PhD degrees.

*Social security premium support (50%)*

Half of the employer's portion of social security premiums for R&D and support personnel (a maximum of 10% of the number of full time R&D personnel) will be funded by the Ministry of Finance.

*Stamp tax exemption*

Documents prepared for R&D activities, including the payrolls of R&D and support personnel, are exempt from the stamp tax.

### 3. Law No. 4691 on technology development zones

*Corporate income tax exemption*

The profits derived from software activities or products developed as a result of research and development activities in technoparks are exempt from corporate income tax.

*Income tax exemption (100%)*

The salaries of R&D and support personnel carrying out R&D and software development activities in technoparks are exempt from income tax until 31 December 2023. Salaries for activities other than software development and R&D activities cannot benefit from income tax exemption.

*Social security premium support (50%)*

Half of the employer portion of social security premiums for R&D and support personnel (a maximum of 10% of the number of full time R&D personnel) will be funded by the Ministry of Finance.

*Stamp tax exemption (only on payrolls)*

The payrolls prepared for R&D activities are exempt from the stamp duty.

*VAT exemption*

Delivery of software and services (system management, data management, business applications, internet, mobile and sector applications, military command control applications) arising from software development activities by companies operating in technoparks are exempt from the VAT until 31 December 2023.

## *Institutions providing cash support on project basis*

- Scientific and Technological Research Council of Turkey (TÜBİTAK )
- Turkish Technology Development Foundation (TTGV)
- Ministry of Science, Industry and Technology
- Small and Medium Industry Development Organization (KOSGEB)
- Development agencies
- European Commission

## *Investment support programme for technological products*

The Ministry of Science, Industry, and Technology provides funding support to companies operating in Turkey for:

- Investments for the production of technological products which are successfully completed as a result of R&D and innovation projects (projects supported by governmental institutions, foundations established under law or international funds, projects successfully started and completed in Technology Development Zones)
- Investments for the production of technological products developed as a result of R&D activities carried out in Turkey and abroad with their own resources and with obtained patent rights for the product

The support includes machinery and equipment support, loan interest support, and operation cost support for companies based on their scale.

### 4. Law No. 6518 on support of patent rights and utility models

Revenue derived from the rental of inventions arising as a result of research; development, innovation, and software activities carried out in Turkey; its transfer, sale, or marketing as a result of mass production; and part of the revenue that’s only attributed to the patented or utility model certified (by the Turkish Patent Institution) invention, derived from the sale of the products manufactured as a result of the use of the invention in the production process in Turkey, is exempt from corporate tax by 50%, in accordance with the conditions stated in legislation. Moreover, the leasing, transfer or sale of the intellectual property rights regarding patented or utility model certified inventions arising as a result of R&D, innovation, and software activities carried out in Turkey are also exempt from the Value Added Tax.

# 6. Electronic transformation

## 6.1. E-invoicing

E-invoicing application rules establish that the Revenue Administration is the mandatory hub for the exchange of invoices in electronic format. This means that the secure circulation of e-invoices between registered parties must be conducted through the Revenue Administration. Users who benefit from the e-invoicing application can:

- send e-invoices to other registered users
- receive e-invoices from other registered users
- download e-invoices, store them electronically, and present them to the authorities when required

In accordance with General Communiqué No. 421, the following groups of taxpayers are obliged by the Ministry of Finance to send invoices electronically:

- taxpayers that hold mineral oil licenses within the scope of the Petroleum Market Law and taxpayers that purchase goods from the same (and have a minimum gross sales revenue of 25,000,000TRY for the 2011 calendar year)
- taxpayers who produce or import the goods stated in List No. III, attached to the Special Consumption Tax Law, and taxpayers who purchase goods from the same (and have a minimum gross sales revenue of 10,000,000TRY for the 2011 calendar year)
- taxpayers already registered for the e-invoicing application when delivering goods or rendering services to other taxpayers that benefit from the application

Taxpayers in the above scope were supposed to have completed their implementation by 31 December 2013. Taxpayers who did not fall under the above scope may apply to use this application voluntarily. As of January 2015, there were approximately 20,000 companies registered in the e-invoicing system. It is expected that the scope of the obligation will be updated and broadened in the future, and that the number of companies registered in the system will increase to approximately 40,000 in 2016 and 80,000 in 2018.

## 6.2. E-archive

Despite its unfortunate name, the e-archive application is similar to the e-invoicing application, except for the fact that the Revenue Administration does not act as a mandatory hub. This application was designed to allow companies to issue invoices in electronic form to taxpayers who are not registered in the e-invoicing system and to end consumers.

According to General Communiqué No. 433 (updated in the meantime with Communiqué No. 443), only companies registered with the e-invoicing application will be able to apply and register for the e-archive application. However, companies that conduct sales of goods and services through the internet and which show a minimum gross sales revenue of 5,000,000TRY on their 2014 income statements will be obliged to register for the e-archive application by completing all necessary application and implementation requirements by 1 January 2016.

E-archive invoices will be reported to the Turkish Revenue Administration on a monthly basis. It is expected that the scope of obligation will be updated and broadened in the future.

## 6.3. E-bookkeeping

The e-bookkeeping application will become a substitute for companies whose current obligation is keeping their journals and general ledgers as hardcopies. Accordingly, taxpayers will be expected to keep their ledgers in electronic format in accordance with the formats and standards established by the authorities in Communiqué Nos.1 and 2 on e-bookkeeping.

Taxpayers shall use a solution approved by the tax authorities to create their electronic ledgers in accordance with the established standards. Each month, ledgers shall be electronically stamped and the respective summary approval file must be uploaded to the Revenue Administration's e-bookkeeping portal by the end of the third following month.

According to aforementioned Communiqué No. 421, taxpayers who fall within the scope of e-invoicing are also obliged to start using the e-bookkeeping application by 1 January 2015. Taxpayers who are not within this scope may apply to use this application voluntarily. It is expected that the scope of the obligation will be updated and broadened in the future, increasing the number of companies registered in the system to approximately 40,000 in 2016 and 80,000 in 2018.

**Electronic record keeping requirements**

The Revenue Administration introduced these requirements via General Communiqué No. 431 with the aim of standardization, and in cases of need, the ability to access certain data that taxpayers in the petroleum products market and the tobacco products market keep in their accounting and/or ERP systems.

The core purpose of this communiqué is to allow the Revenue Administration to acquire standardized data from the aforementioned groups of taxpayers and to conduct a comparative analysis of the data in order to increase the efficiency of their tax audits.

Taxpayers conducting operations under the scope of List I of the Special Consumption Tax Law, as well as taxpayers in the tobacco products market who are affected by this regulation should keep specific information for the following records in electronic format:

- sales records
- purchase records
- inventory records related period beginning and period end stock
- import records
- export records
- production records
- other records

In the scope of the electronic record keeping requirements regulation, companies were expected to start keeping the above mentioned information in electronic format starting from 1 January 2015. It is expected that the scope of the obligation will be updated and broadened in the future, with authorities planning to make it mandatory in other sectors.

Additionally, there are other applications, such as the e-ticket application, and obligations, such as the new generation cash register devices, that also impact companies conducting business activities in Turkey, especially in the retail sector. In addition, it is expected that new applications, such as e-waybill and e-payment, will be implemented by the Revenue Administration in the near future.

## PwC Turkey

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PwC has been providing services to the Turkish business world since 1981, with five offices located in four cities; İstanbul, Ankara, Bursa, and İzmir. With a a professional staff of 1,500, we provide services to create the value that our clients look for.

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