



SCREENING CHAPTER 16 TAXATION

DIRECT TAXATION

AGENDA ITEM : CORPORATE TAXES

**Country Session: The Republic of Turkey
11-12 July 2006**



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Legal Basis (1/4)

➤ Former Corporate Income Tax Law No. 5422 (Official Gazette no 7229, dated 10.06.1949)

It has remained in force until 31.12.2005 and has been amended by Corporate Income Tax Law No.5520. However, its provisions shall continue to be in force within time lapse periods.

➤ Corporate Income Tax Law No. 5520
(Official Gazette no 26205, dated 21.06. 2006)

➤ Its provisions shall be effective as of 01.01.2006.



Legal Basis (2/4)

Corporate Income Tax Law No. 5520

- The rationale that lies behind the amendment of Corporate Income Tax Law No.5422 is changing its structure as well as updating it in order to respond to current economic and social needs.
- Economic activities and in particular trade have gained an international character in an increasing trend, making it irrational for the states to make regulations that solely cover the domestic activities of resident companies.
- The new era makes it impossible to deal with the issue of foreign investment by merely relying on daily decisions and thus calls for a sound legal infrastructure that takes into account this fact.



Legal Basis(3/4)

Corporate Income Tax Law No. 5520 (Cont'd)

- The Law complies with the facts of this new era as well as the long term strategic goals of the country. It is designed with an innovative and taxpayer-focused understanding that supports growth, provides a tax environment with low tax rates and covers a wider span of taxpayers.
- Particularly concerning non-residents, it gathers the provisions which display an unintegrated structure in the former Law in a systematic way.



Legal Basis(4/4)

Corporate Income Tax Law No. 5520 (Cont'd)

New Rules;

- Rules concerning “Transfer Pricing” and “Controlled Foreign Company “CFC” are integrated into the Corporate Tax Law No.5520 making it more compatible with the legislation of the EU as well as the OECD rules (Art.7,13).
- Existing thin capitalization rules have also been amended to comply with the EU and OECD norms (Art.13).
- There is a 30% withholding tax on the money transferred (cash or accrual) to the corporations or to branches located in the countries (tax heavens) determined by the Council of Ministers.



Definitions in Corporate Income Tax Law (1/4)

➤ Full Liable Corporation (FLC) (Art.3):

FLC should have;

- Registered office or center of business in Turkey,
- Resident for tax purposes in Turkey

and

- FLCs are subject to corporate tax on their worldwide income.

Definitions in Corporate Income Tax Law (2/4)

➤ Non-Resident Corporation (NRC) (Art.3)

NRC should have;

- Neither of registered office or center of business in Turkey
- and
- Only income earned/gained in Turkey is subject to tax.



Definitions in Corporate Income Tax Law (3/4)

Taxable Income for Non-Resident Corporations;

Corporate profits of non-residents consist of the gains and profits stated below:

- Business profits derived by foreign corporations having a Permanent Establishment (PE) or permanent representative in Turkey in accordance with the Tax Procedure Law, from the activities carried on in these places or through these representatives.
- Gains derived from an agricultural business situated in Turkey.
- Gains from independent activities in Turkey.



Definitions in Corporate Income Tax Law (4/4)

Taxable Income for Non-Resident Corporations (Cont'd)

- Gains derived from the rental of movable and immovable property and rights in Turkey.
- Gains derived from securities in Turkey.
- Other profits and gains derived in Turkey.



Restructuring of Corporations

- 1- Merger
- 2- Division “Split-Up”
- 3- Partial Division “Split-Off”
- 4- Exchange of Shares



Merger (1/6)

Definition:

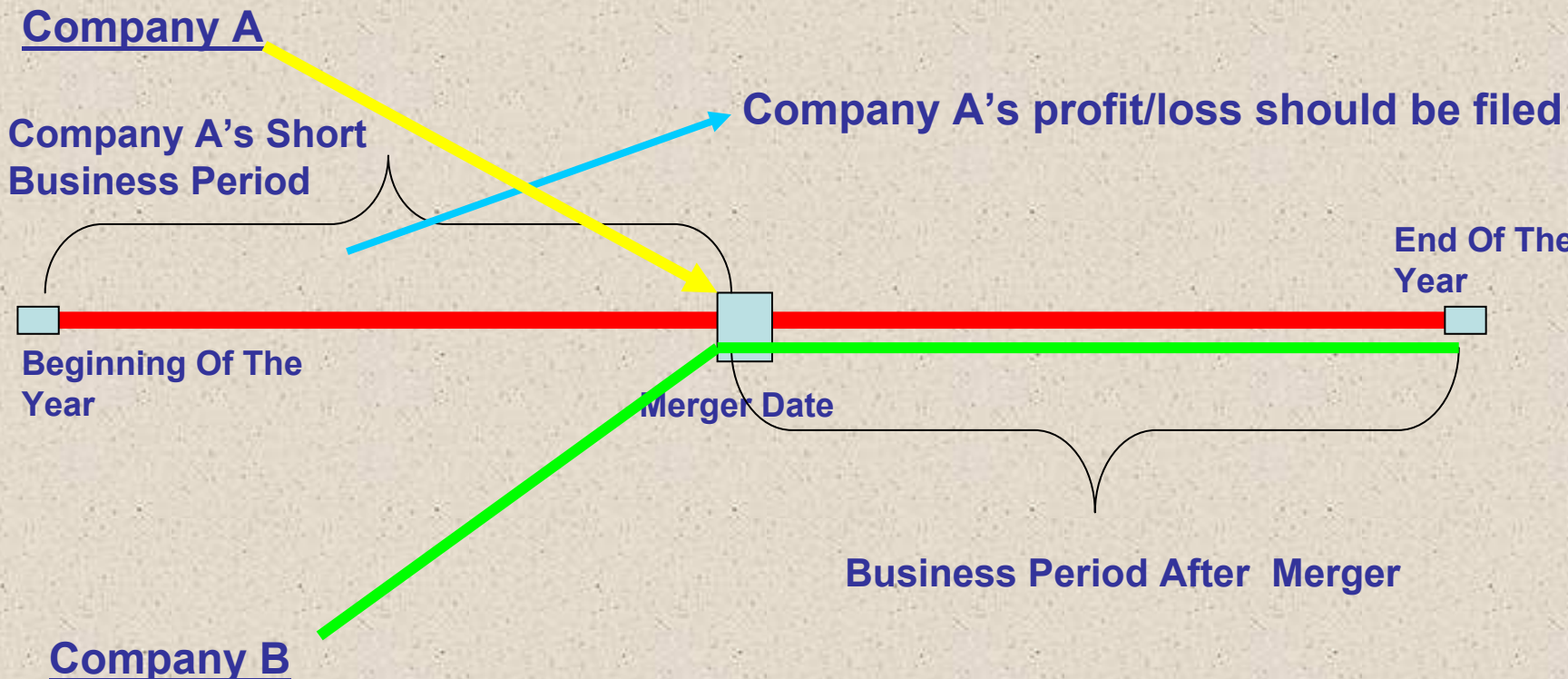
Merging of one or more corporations with another corporation is considered as liquidation for the corporation dissolving due to the merger(Art. 18).

Restructuring operation is a merger if;

- Both transferring and receiving corporations are considered as resident for tax purposes in Turkey (full liability).
- Assets and liabilities at the date of transfer are transferred exactly and as a whole.
- Changing type of corporations under above mentioned conditions is also deemed as merger.



Merger (2/6) Conditions for Tax-Free Mergers



- The date of merger is the date on which authorized board decision is registered in Trade Register(Art.20/1)



Merger (3/6)

Conditions for Tax-Free Mergers (Cont'd)

On a merger if the below conditions are met, only the profits of dissolving company accruing until the date of merger are taxed. But gains arising from the merger are not taxed. (Art. 20/1-b)

- Corporate tax return of the dissolving company prepared as of merger date,
- corporate tax return of the dissolving company for the previous taxation year (if the date of merger falls between the period from the end of the last taxation period and corporate tax return due date),

should be;

- signed by both parties,
- filed to dissolving company's tax office within 30 days from the announcement date of the merger in the Trade Registry Gazette



Merger (4/6)

Conditions for Tax-Free Mergers (Cont'd)

- Receiving company promises with a written engagement enclosed to the corporate tax return of transferring company filed due to merger;
- to pay the tax debts of the transferring company accruing until and after the merger date and,
- to fulfill other obligations.

- Relating to this subject, the authorized local revenue officer could ask for guarantee from receiving company.



Merger (5/6)

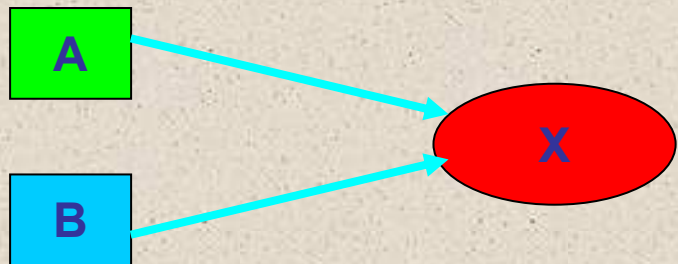
Example

(A) and (B), partners of company (X), transferred this company as a whole to the company (Y) whose partners are (C) and (D). After transfer, shares of company (Y) are given to (A) and (B) in exchange for the transfer.



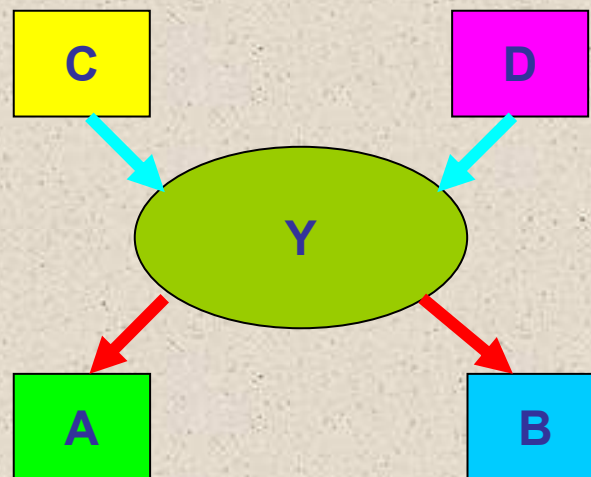
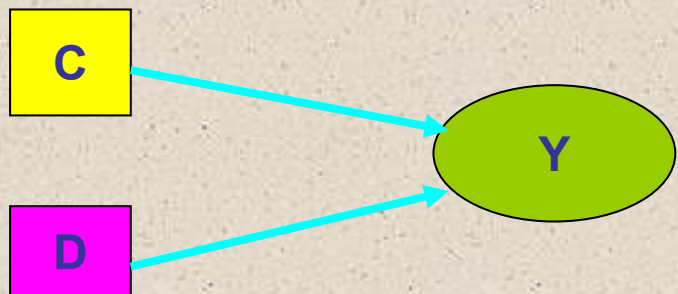
Merger(6/6) – Example(Cont'd)

Before Merger



After Merger

Company X is dissolved





Division “Split-up” (1/6)

Definition:

A full-liable equity company, on being dissolved without liquidation transfers to two or more existing or new full-liable equity companies all of its assets and liabilities at book value, in exchange for the pro-rata issue to its shareholders of securities representing the capital of the companies receiving the assets and liabilities, and if applicable a cash payment not exceeding 10% of the nominal value of those securities. (Art. 19/3-a)



Division “Split-up”(2/6) Conditions for Tax-Free Division

On a division, if the below conditions are met only the profits of splitting company accrued until the date of division are taxed where those arising from the division are not: (Art. 20/2)

- Corporate tax return of the splitting company prepared as of division date,
- Corporate tax return of the splitting company for the previous taxation year (if the date of division falls between the period from the end of the last taxation period and the end of the month of filing corporate tax returns);



Division “Split-up”(3/6) Conditions for Tax-Free Division (Cont'd)

should be;

- signed by both parties,
 - filed to split company’s tax office within 30 days from the announcement date of the division in the Trade Registry Gazette,
- Receiving companies promise with a written engagement enclosed to the corporate tax return of transferring company filed due to division, to be successively liable from the tax debts of the transferring company accruing until and after the division date and to fulfill other obligations. Relating to this subject, the authorized local revenue officer could ask for guarantee from both parties (transferring and receiving companies).



Division “Split-up” (4/6) Example

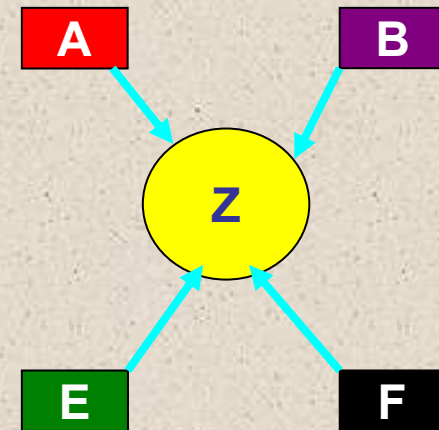
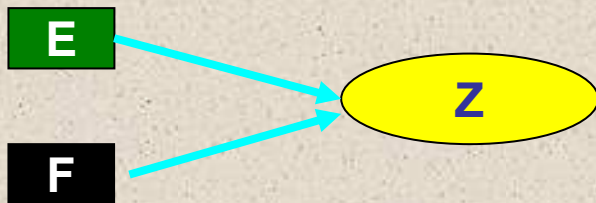
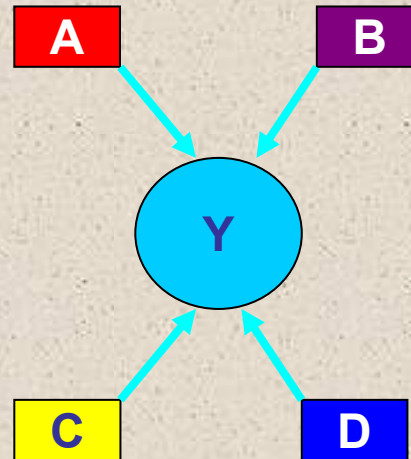
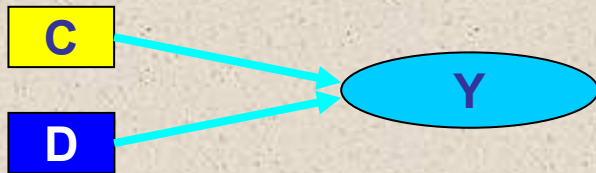
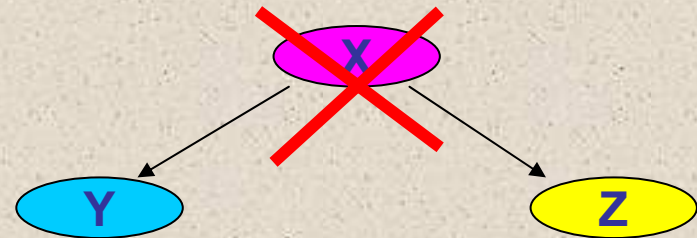
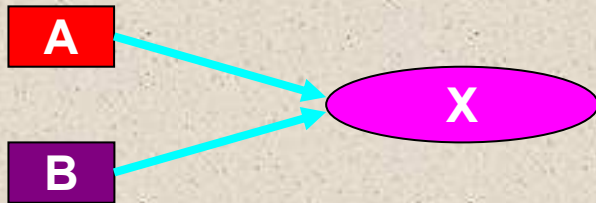
Before division, (A) and (B) are partners of Company (X), (C) and (D) are partners of company (Y), (E) and (F) are partners of company (Z). Company (X) is divided transferring all its assets and liabilities to company (Y) and (Z) and it ceases to exist. Following the division (A) and (B) become partners of Company (Y) and (Z). In this example, partners may be both real persons and legal persons.



Division "Split-up" (5/6) / Example (Cont'd)

Before Division

After Division



Division “Split-up”(6/6) Example (Cont'd)

For a tax-free division:

- Splitting company (X) and receiving companies (Y) and (Z) should all be equity companies,
- Splitting company (X) and receiving companies, (Y) and (Z) should all be full liable,
- Splitting company (X) is dissolved without liquidation,
- Splitting company (X) should transfer all assets and liabilities at book value,
- Pro-rata issue to splitting company’s shareholders of securities representing the capital of the receiving companies.



Partial Division “Split-Off”(1/8)

Definition:

- Partial division is an operation whereby a full liable equity company or a permanent establishment or permanent representative of a foreign equity company transfers as capital in kind at book value its participating shares with a minimum holding of two years and fixed assets or branch of production or service activity to another existing or new full-liable equity company.
- Shares in exchange for the capital in kind are either kept by the transferring company or issued to its shareholders.



Partial Division “Split-Off”(2/8)

- Concerning transfer of branch of production or service activity, transfer of all assets and liabilities necessary for the continuation of activity in a manner protecting integrity of business is compulsory. (Art. 19/3-b)
- Concerning transfer of fixed assets and participating shares where securities representing the capital of the receiving companies are issued to the shareholders of splitting company, transfer of liabilities relating to the transferred values is compulsory.



Partial Division “Split-Off”(3/8)

- Gains arising from the partial divisions shall not be computed or taxed.
- On a partial division, receiving companies are successively liable from the tax debts limited to the fair market value of the assets received, of the transferring company accruing until and after the division date (Art. 20/3).



Partial Division “Split-Off”(4/8) Conditions for Tax-Free Partial Division

- Transfer of shares with a minimum holding of two years and fixed assets or branch of production or service activity,
- Concerning transfer of branch of production or service activity, transfer of all assets and liabilities necessary for the continuation of activities in a manner protecting integrity of business,
- Capital put up in kind is transferred at book value,
- Shares in exchange for the capital in kind are either kept by the transferring company or issued to its shareholders.



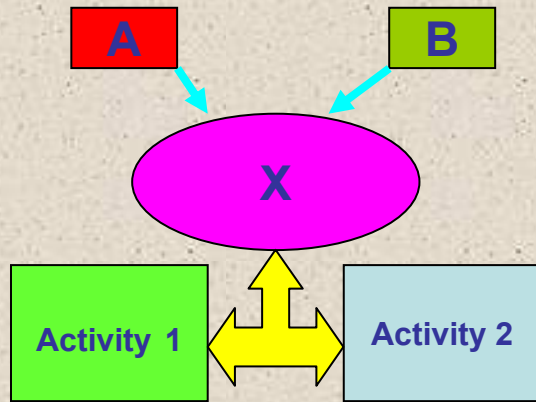
Partial Division “Split-Off” (5/8) Example

(A) and (B) are partners of Company (X), (C) and (D) are partners of Company (Y) before partial division. Activity 1 of (X) Company is transferred to Company (Y). In the first case, shares of Company (Y) acquired in exchange for the shares of company (X) become a part of assets of Company (X); whereas, these shares are transferred to (A) and (B) in the second case, and as a result of this (A) and (B) become the partners of both Company (X) and (Y).

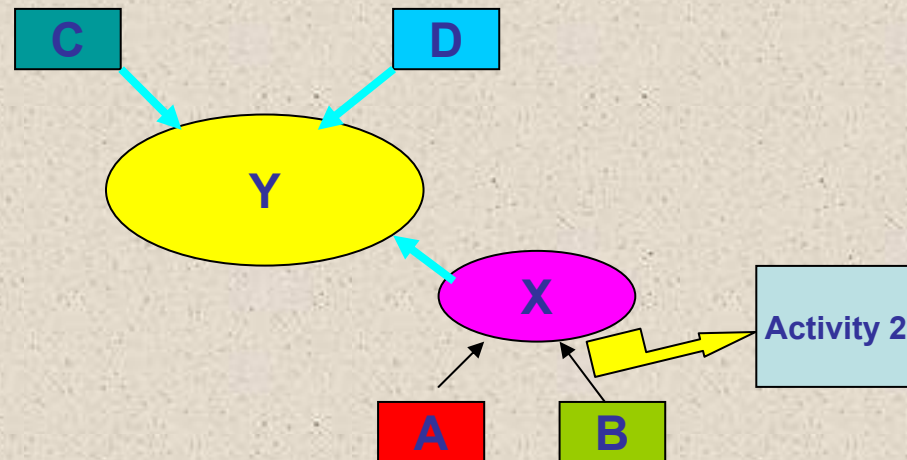
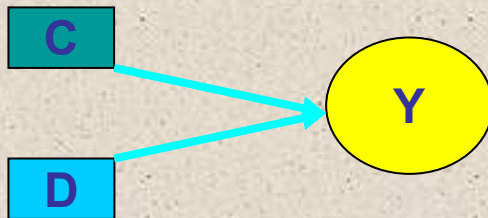
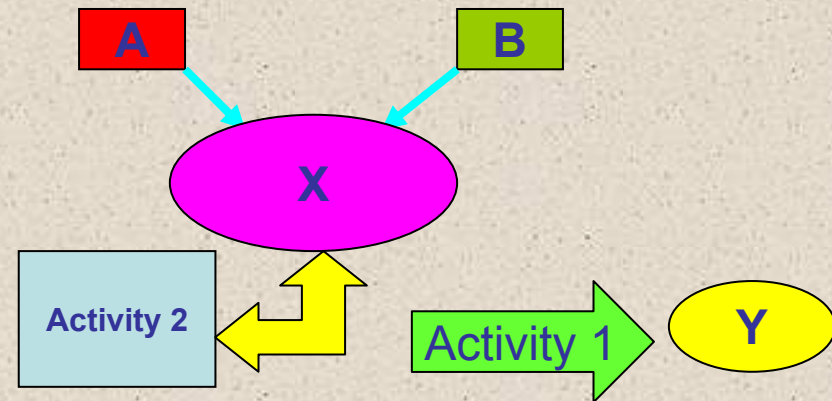


Partial Division "Split-Off" (6/8) Example (Cont'd)

Before Division



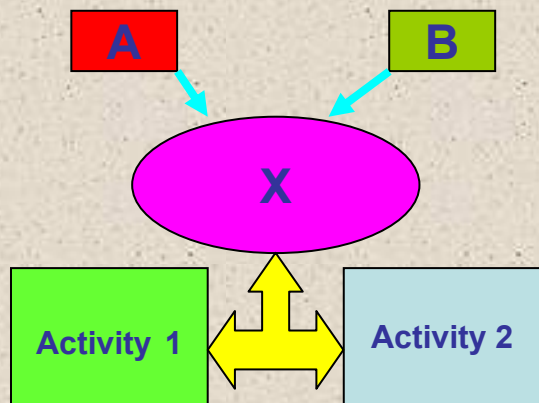
After Division



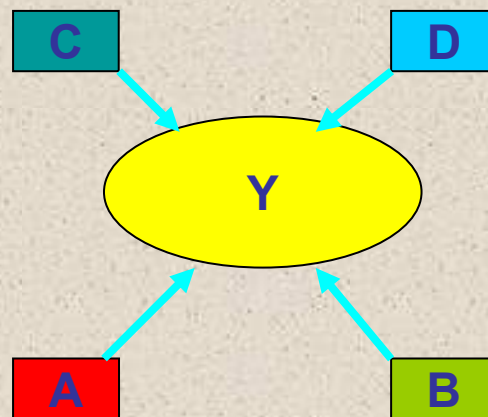
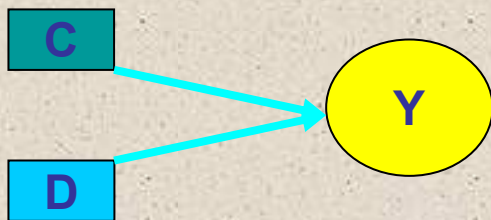
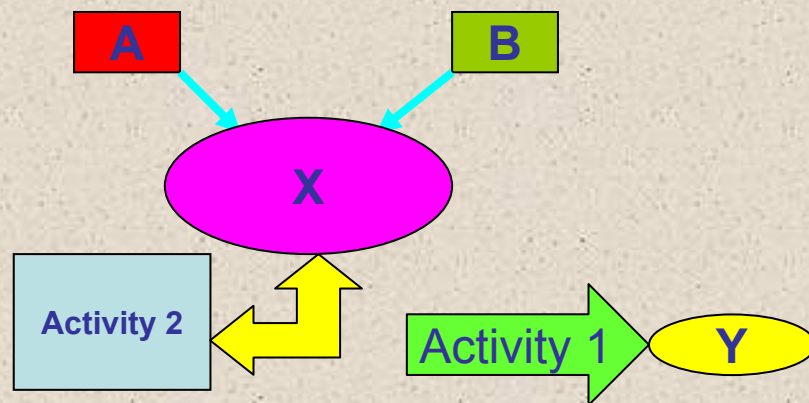


Partial Division "Split-Off" (7/8) Example (Cont'd)

Before Division



After Division



Partial Division “Split-Off”(8/8) Example (Cont'd)

For a tax-free partial division:

- Splitting company (X) and receiving company (Y) should both be equity companies,
- Splitting company (X) should be;
 - full liable or
 - a PE or a permanent representative of a foreign company in Turkey,
- Receiving company (Y) should be full liable.



Exchange of Shares(1/4)

Definition:

- Exchange of shares is an operation whereby a fully liable equity company acquires a holding in the capital of another equity company such that it obtains the majority in the management and capital stock of that company, in exchange for the pro-rata issue to the shareholders of the latter company securities representing the capital of the former company, and if applicable a cash payment not exceeding 10% of the nominal value of those securities (Art.19/3-c).
- Gains arising from the exchange of shares shall not be computed or taxed (Art 20/3).



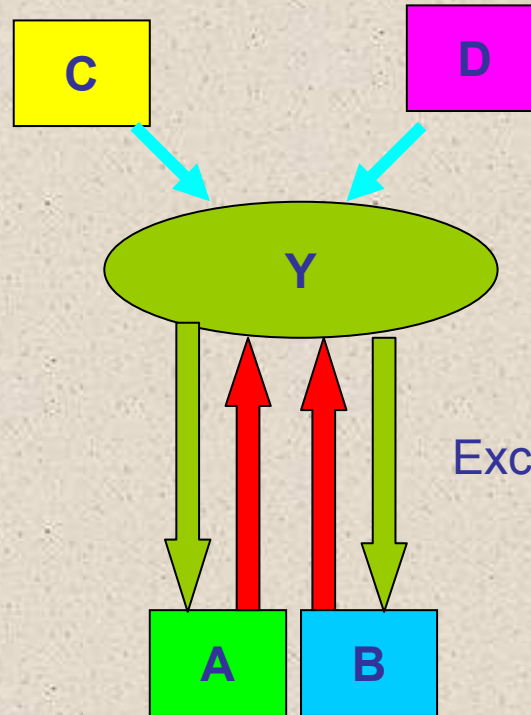
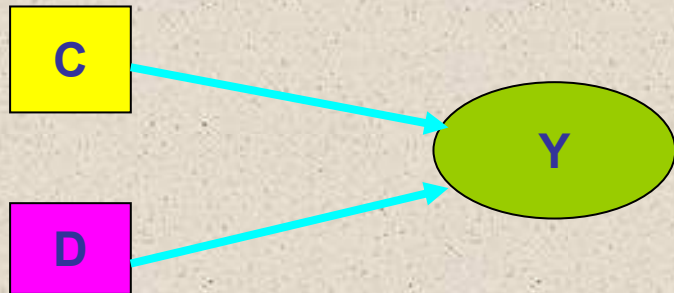
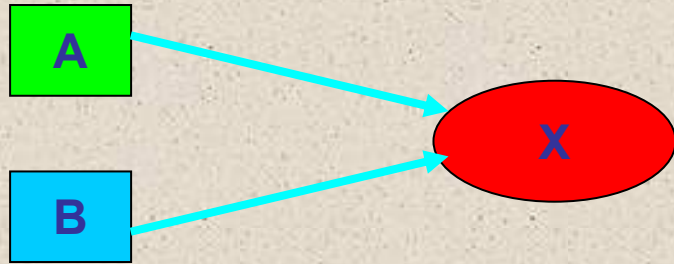
Exchange of Shares(2/4) Example

(A) and (B) who are partners of Company (X) transfer their shares in this company to Company (Y) in exchange for shares of Company (Y). Indeed, the transaction is the putting of (A) and (B) (partners of Company (X)) their stocks in Company (Y) as capital in kind. As a result of that, (A) and (B) become partners of Company (Y) along with (C) and (D) by means of acquiring shares of (Y).



Exchange of Shares (3/4) / Example (Cont'd)

Before Exchange of Shares | *After Exchange of Shares*



Exchange of Shares(4/4) Example (Cont'd)

For tax-free Exchange of Shares

- Receiving company (Y) and Transferring company (X) should both be equity companies,
- Receiving company (Y) should be full liable,
- Receiving company (Y) should take over shares of the transferring company (X) such that it obtains the majority in the management and capital stock of (X),
- Pro-rata issue to the shareholders of the transferring company (X) securities representing the capital of receiving company (Y).



Parent/Subsidiary Relations (1/7) (Parent -Subsidiary/Branch)

Between Full Liable Corporations;

- Exemption of dividends received (Art. 5-1).
- No minimum holding rate or holding period requirement for the shares of subsidiary's capital.
- No withholding tax on dividend distribution between full liable corporations (PIT No: 193, Art.94/6-b).
- Economic double taxation eliminated in domestic terms.



Parent/Subsidiary Relations (2/7) (Parent -Subsidiary/Branch)

Dividend Distributions of FLCs and Branch Profits Transferred Abroad

- 10% withholding tax on dividend distributions from a FLC to a partner corporation resident of a foreign country (PIT No: 193, Art.94/6-b).



Parent/Subsidiary Relations (3/7) (Parent -Subsidiary/Branch)

- 10% withholding tax on the remaining part of profits derived by a PE of a foreign company, and transferred to parent company, after the corporate tax has been paid (PIT No 193, Art. 94/6-b).
- Most double taxation agreements have ceiling rates for such withholdings.



Parent/Subsidiary Relations (4/7) (Parent -Subsidiary/Branch)

Foreign Dividends and Branch Profits of FLCs

➤ Economic double taxation related to dividends received by a FLC from a foreign company (subsidiary) or related to foreign branch profits is eliminated either by exemption or tax credit method.



Parent/Subsidiary Relations (5/7) (Parent -Subsidiary/Branch)

➤ Qualifying dividends/profits derived from an interest in a foreign company or from branches located abroad are exempt from corporate tax

if;

- Corporation has a minimum 10% share in the paid-up capital of foreign company.
- Holding continues for an uninterrupted period of at least one year.
- Gross amount of dividends/profits should bear a minimum of 15% tax-burden similar to Turkish corporate/personal income tax according to the laws of the country in which subsidiary or branch operates (Art. 5-1).



Parent/Subsidiary Relations (6/7) (Parent -Subsidiary/Branch)

- Where the main activity is security investments, insurance services or funding including leasing; gains should carry at least the same rate of tax burden with Turkish corporate tax according to the laws of the country in which the subsidiary carries on its business.
- Profits should be transferred to Turkey before due date of corporate tax return for the relevant year.



Parent/Subsidiary Relations (7/7) **(Parent -Subsidiary/Branch)**

- Branch profits derived from construction, maintenance and assembly works outside Turkey are exempt from tax without any conditions (Art. 5/1-h).
- Unless profits from a foreign subsidiary or branch are exempt, taxes paid abroad including corporate tax can be credited from the corporate income tax calculated for such gains in Turkey (Art.33).
- Corporate gains derived from the alienation of foreign participation shares with minimum 2 years of holding are exempt provided that; these gains are derived by parent companies of which 75% or more of the company's assets other than net assets consist of minimum 10% of participation in capital stock of foreign subsidiaries (Art.5).



Interest and Royalty Relations Between Companies(1/5)

Between FLCs

- Law on Corporate Income Tax No.5520 obliges the taxation of corporations on a separate basis, where it does not enable the related or group corporations to consolidate their profits.
- Regardless of whether the companies are associated or not, interest payments arising from debts or royalty payments between FLCs are not subject to any withholding tax. However, these payments are regarded as a deduction item for the payer and a taxable profit item for the beneficial owner. Accordingly they are subjected to corporate income tax.



Interest and Royalty Relations Between Companies(2/5)

Interest and Royalty Payments to Companies Located Abroad

➤ Whether the company being the beneficial owner of payments is an associated company or not, interest and royalty payments made by full liable corporations to corporations located abroad are subject to withholding tax in Turkey (Art.30).



V-Interest and Royalty Relation Between Companies(3/5)

Interest and Royalty Payments to Companies Situated Abroad (Cont'd)

- The Council of Ministers is authorized to set the withholding tax rates (Art. 30/8);
- Since 1985, the rate is zero on interest payments to foreign financial institutions (Cabinet Decree No:2003/6575).
- The rate is 10% on interest payments to foreign companies other than financial institutions.



Interest and Royalty Relations Between Companies(4/5)

Interest and Royalty Payments to Companies Situated Abroad (Cont'd)

- On royalty payments to foreign companies;
 - 25% on sale of royalties
 - 22% on leasing of royalties (Cabinet Decree No. 2003/6575)
- Most of the double taxation agreements include ceiling rates.



Interest and Royalty Relations Between Companies(5/5)

Interest and Royalties Derived from Foreign Companies

➤ Whether the foreign company, the payer, is an associated company or not, interest and royalties derived by FLCs from corporations located abroad are taxed at a normal rate as an element of the taxable income of the FLC situated in Turkey.



Miscellaneous

Loss Carry Forward on Merger And Division

- On a merger or division, losses of transferring company not exceeding the equity capital of transferring company as of the date of transfer may be carried forward by the receiving company (Art. 9/1-a).
- **Conditions for loss carry forward;**
 - Limited to 5 years,
 - Corporate Tax Returns should have been filed in due time for the last five years,
 - Operations of transferring company shall be carried on at least for five years.



Miscellaneous Cancellation of Holding Securities

Where a company which has a holding in the capital of another company takes over as a whole the assets and liabilities of the latter one, any gains accruing to the former company by reason of cancellation of its holding will not give rise to any taxation (GC of CIT Law No. 67).



Miscellaneous Anti-Abuse

- No separate anti-abuse provisions designed for restructuring operations.
- Existing provisions do not give Revenue Administration the option of refusing to apply the rules laid down to encourage such operations.
- The Law requires that in case of loss carry forwards, the operations of the transferring company shall be carried on at least for five years.
- The loss take over is limited to the equity capital on the date of transfer of the transferring company.

Miscellaneous

Transfer of Registered Office

- Rules designed for the taxation of restructuring operations are of domestic nature, thus transfer of registered office is not the case within the scope.
- Transferring the registered office within the country does not give rise to any taxation, whereas transfer of the registered office outside the country which transforms the enterprise in Turkey into a PE, shall result in taxation.
- However, a foreign corporation can transform its PE situated in Turkey into a full liable corporation by means of partial division without giving rise to any taxation.



Miscellaneous Capital Duty

Capital duty concerning capital company establishment and capital contributions is abolished by Law No. 5228 at 31.07.2004



THANK YOU FOR YOUR ATTENTION