Turkey

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General

1. What are recent tax developments in your country which are relevant for M&A deals?

Recently, there are no tax developments in Turkey which are relevant for M&A deals. The regulation regarding the deductibility of the expenses and cost items relating to foreign resources utilised in companies, was valid effective from 1 January 2013. According to this regulation, if the amount of foreign resources exceeds the equity capital of the company, financial expense restriction will be applicable. The rate of restriction for the concerned type of expenses shall be determined by the Council of Ministers, but this rate will not exceed 10%. Please note that as of February 10, 2016, Council of Ministers decision related to this issue is not published yet.

2. What is the general approach of your jurisdiction regarding the implementation of OECD BEPS actions (action Plan 6 specifically) and, if applicable, the amendments to the EU Parent-Subsidiary Directive?

The OECD introduced the Base Erosion and Profit Shifting (BEPS) project with 15 Action Plans including Action 6: Preventing the granting of treaty benefits in inappropriate circumstances. The preparation process for the adaptation of the action plan to local legislation still continues in Turkey. However, as of today there is not any regulation for BEPS and Action 6. Ministry of Finance announced that some regulation will be in new Tax Procedures Law.

3. What are the main differences among acquisitions made through a share deal versus an asset deal in your country?

Asset deals and share deals have different results for capital gains taxes, value added tax, stamp duty and other taxes in Turkey.

Share deal

If the shareholder is an individual:

- If the seller has held the shares of a joint stock company for more than two years, there is no taxation on the capital gain. Otherwise, the capital gain is subject to taxation as per the tariff in Turkey's Income Tax Code, i.e., from 15% to 35%. If the company being sold is a limited liability company that does not have share certificates, then the capital gain is subject to taxation as per the tariff in the Income Tax Code.
- Share sales to individuals are not subject to value-added tax.

If the shareholder is a Turkish resident company:

- If the Turkish resident company has held the shares of the company (a joint stock company or a limited liability company) for more than two years, then 75% of the capital gain is exempt from taxation and the remaining 25% is subject to corporate income tax of 20%. In other words, the effective tax rate is 5%.

  Sale price: 200

  Cost price: (100)

  Capital gain: 100

  Exempt income: 75

  Taxable income: 25

  Corporate income tax (20%): 5

- For a buyer to benefit from this exemption, the sale price should be collected until the end of the second year in which the sale transaction is realised. Additionally, the exempt amount cannot be distributed for five years.
- If the holding period is less than two years, there is 20% corporate income tax.

If the shareholder company is not resident in Turkey:

- If the buyer is also not resident in Turkey, there is no taxation in Turkey. Taxation will be in the country where the shareholder of the company is resident.
- If there is a double tax treaty between Turkey and the country where the seller is resident, the treaty is applicable.
- If the shareholder is a company that has held the shares for more than two years, there is no VAT on the sale transaction.
- If there is a written agreement between the parties, there might be stamp tax payable on the agreement, depending on the nature of the agreement.

As explained above, depending on the details of the transaction, an asset deal can be subject to more tax than a share sale.

Merger, demerger and share exchange transactions where applicable are tax-free transactions under Turkish tax legislation, provided that the conditions stated in the legislation are fulfilled.

Asset deal

The capital gain on a sale of assets is subject to 20% corporate income tax. Capital gains are based on the difference between the net book value of the assets in the balance sheet and the sale price.

There is VAT of 18% on the sale price.

On the other hand, 75% of the gains from the sale of any real estate assets that have been held for at least two years may be exempt from corporate income tax, if:

- The sale price is collected before the end of the second calendar year following the year in which the sale occurred;
- That portion of the gain benefitting from the exemption is maintained in a special reserve account on the balance sheet for 5 years; and
- The selling company's business is not the trading or leasing of real estate.

In addition to this, the sale of any real estate assets that have been held for at least two years may be exempt from VAT.

Where there is a written agreement between the buyer and seller, there might be stamp tax of 0.948% on the amount mentioned in the agreement. However, the stamp tax is subject to a ceiling for stamp tax liability, which for the year 2016 is set at TL 1,797,117.30 per each copy.

Land and building transfer will be subject to title deed charge at a rate of 2%. The basis of deed is sale price where the sale price is lower than the tax value determined by the municipality, the tax value is the base. Title deed should be paid on registration day at the title deed office. Applicable for both buyer and seller, therefore total rate is 4%.

Buy-side

4. What strategies are in place, if any, to step up the value of the tangible and intangible assets in case of share deals?

For statutory accounting and tax purposes, it is not possible to step up the value of the assets in the books, since the assets are booked on the purchase values and subject to depreciation on the accounts.

These assets are subject to valuation, which may affect the sale price of the shares.

Transfer pricing rules — i.e., the arm's length principle — apply in the case of a sale to related parties.

5. What are the particular rules of depreciation of goodwill in your country?

Depreciation rates are determined and announced by the Ministry of Finance, based on the useful life of the assets. The latest rules are applicable to fixed assets purchased after January 1, 2004.

For fixed assets other than passenger cars, depreciation is granted for the full year, regardless of the acquisition date of the asset. For passenger cars only, depreciation for the year of acquisition is calculated on pro-rata basis.

Two methods are available to taxpayers: straight-line method and declining-balance method. A taxpayer who initially chooses the declining-balance method for an asset may switch to the straight-line method. The taxpayer then spreads the written-down value over the remaining years, allowing for equal depreciation. However, those who begin with straight-line method may not switch to the double-declining method.

Intangible assets, like capitalised start-up costs and goodwill, are depreciated over five years. For start-up costs and goodwill, the declining-balance method is not allowed under the Turkish procedures code.

6. Are there any limitations to the deductibility of interest on borrowings?

Effective from 1 January 2013, regarding the deductibility of the expenses and cost items relating to foreign resources utilised in the companies such as interests, commissions, delay interests, foreign currency losses and other costs and expenses. According to this regulation, if the amount of foreign resources exceeds the equity capital of the company, financial expense restriction will be applicable. The rate of restriction for the concerned type of expenses shall be determined by the Council of Ministers, but this rate will not exceed 10%. Please note that as of 10 February 2016, Council of Ministers decision related to this issue is not published yet. However, the following issues should be taken into consideration:

Deductibility of interest on borrowing

The portion of the interest expenses relating to the loans used to finance investments and the foreign exchange differences relating to the loans in foreign currency used to import fixed assets that have incurred until the year-end date of capitalisation (acquisition) must be carried to cost, under Tax Procedures Code General Communiqué Series No. 163. The portion of the interest expenses relevant to the period subsequent to the capitalisation (acquisition) must either be recorded as expense directly or be carried to the cost of the concerned investment or fixed assets and become subject to depreciation, depending on the preference of the taxpayer.

Meanwhile, Tax Procedures Code General Communiqué Series No. 334 states that the portion of the foreign exchange differences that have occurred until the date of capitalisation must be associated with the cost. The favourable or negative foreign exchange differences that occur subsequent to the date of capitalisation must either be treated as foreign exchange gains or be deducted from the cost and become subjected to depreciation. Moreover, during the subsequent periods, the concerned taxpayer is obliged to adhere to the method selected during the previous period and to continue to apply the same method on the transactions.

Transfer pricing

Transfer pricing through disguised profit distribution is defined in Article 13 of Corporation Tax Code No. 5520:

"Corporations shall be deemed to have distributed profits in a disguised manner through transfer pricing, if they are engaged in buying of goods and services from persons or entities that are in the position of related parties, at prices or amounts that are not in conformity with the arm's length prices or values."

The same provision also states in a definite manner that all transactions that involve buying, selling, manufacturing, construction operations, lending and borrowing of money, and the payments of monthly salaries, bonuses, wages, or the like, must be considered as the purchase of goods and services, under whatever circumstances.

The concept of "related party" in the regulation refers to the real persons or entities to which the corporation, its own partners or the real persons or entities who have ongoing relations with the partners are affiliated, or which are under the control of the corporation, its partners or their related parties, from the standpoint of management, supervision or capital.

Thin capitalisation rules

According to the rules on thin capitalisation, the minimum required debt-to-equity ratio is 3:1. Any portion of the related-party borrowing that exceeds 3:1 ratio (three times the equity) is treated as "disguised capital". Interest payments and exchange losses corresponding to that portion of the borrowings from the related party are not deductible from the corporate profit. There is also a dividend withholding tax over the disallowable interest.

Interest and exchange losses corresponding to the related-party borrowing up to three times the equity are deductible without any limitation (and without any dividend withholding tax liability), provided that the interest rate is determined according to the arm's length principle.

Borrowings from third parties are not taken into account while making the debt-to-equity comparison.

Borrowings from a related-party bank or a similar credit institution whose main field of activity is lending are taken into consideration at a rate of 50% (hence, the minimum required debt-to-equity ratio is 6:1 for borrowings from related credit institutions). However, if the activity of the credit institution is the procurement of funds among the group companies only, the whole amount of borrowing is taken into account when making the comparison (i.e., a 3:1 ratio is applied).

Loans from third parties under a cash guarantee are treated as a borrowing from a related party and are subject to thin capitalisation rules. Loans from third parties under a non-cash guarantee (like a letter of guarantee) of a related party, however, are treated as external loans and are not subject to thin capitalisation rules.

Tax burden on interest

Withholding tax: According to local legislation, the rate of withholding tax on interest payments is 10%. However, the withholding tax rate is 0% for the following interest payments:

- Interest payments on loans from local banks and credit institutions, and
- Interest payments on loans from foreign banks or credit institutions.

Loans from related-party credit institutions are eligible for 0% withholding tax only if the credit institution is procuring funds to the third parties as well as the group companies. Therefore, credit institutions whose main purpose is the procurement of funds only among the group companies are not eligible for 0% withholding tax.

VAT: In principle, interest payments are subject to VAT at 18%. However, interest payments to local banks and credit institutions are exempt from VAT.

Interest payments to foreign loan providers are subject to reverse-charge VAT at 18%. However, interest payments to foreign loan providers treated as "financial institutions" as per the domestic laws and regulations of the country of their residence (including banks) are not subject to VAT.

Stamp duty: Where there is a written loan agreement, there might be stamp tax of 0.948% on the principal amount mentioned in the agreement.

Resource Utilisation Support Fund (RUSF): According to Communiqué Series No. 6 of the RUSF, the loans in foreign currency obtained from abroad by persons resident in Turkey is subject to RUSF at the rate of 3% if the term is less than one year; 1% if the terms is one to two years; 0.5% if the terms is two to three years; 0% if the terms if more than three years. The loans in Turkish currency obtained from abroad by persons resident in Turkey is subject to RUSF at the rate of 3% over interest amount regardless of the maturity of the loan.

7. What are usual strategies to push-down the debt on acquisitions?

Debt push-down strategies are generally criticised by Turkish tax inspectors.

8. Are losses of the target company(ies) available after an acquisition is made?

As per the corporate income tax code, the previous five years' losses are available provided that the losses are shown on the previous years' corporate income tax declarations separately.

9. Is there any indirect tax on transfer of shares (stamp duty, transfer tax, etc.)?

As per the stamp tax code, written agreements are subject to stamp tax of 0.948% (general rate) in principle. There is no need to make a written share purchase agreement for a sale of the shares of a joint stock company, but the parties may decide to have a written agreement. This agreement may be subject to stamp tax. On the other hand, there are court decisions declaring that a share purchase agreement, there is no need to pay stamp tax provided that this agreement is only a simple sale and share agreement. For different obligations, guarantees, etc., determined in this agreement, there may be stamp tax payable.

For the transfer of the participation shares of a limited liability company, since this transfer should be done by notaries, stamp tax is applied by notaries as 0.948% on the sale price.

10. Are there any restrictions on the deductibility of acquisition costs?

In principle, there is no restriction on deductibility on acquisition costs.

11. Can VAT (if applicable) be recovered on acquisition costs?

Yes, VAT (if applicable) can be recovered on acquisition costs.

12. Are there any particular issues to consider in the acquisition by foreign companies? *(for example non-resident taxation rules/substance rules and tax efficient exit routes)*

Foreign investors can acquire 100% of the shares of Turkish companies in general.

There are no substance rules on the other hand there might be some legal issues or procedures to follow.
For example;

- If the Turkish company is a limited liability company the share transfer agreement should be signed before notary public.
- The foreign investors should be notified to Ministry of Economy
- If 100% of the shares are transferred to foreign investors then there is a need to notify the Trade Registry.
- If there is a regulatory authority in the sector of the Turkish company and if there are restrictions concerning % of foreign investment there might be a need to get a pre-approval from the regulated authority.

Double tax treaty effect

If the target company is registered in a country with which Turkey has a double tax treaty, dividend withholding and capital gains taxes can be reduced.

Controlled foreign corporation regime

Turkey applies controlled foreign corporation legislation. If the participation of the Turkish company is more than 50% in the target company, the income of the target company may also be taxed in Turkey, even if it is not distributed, provided that the following conditions are also fulfilled:

- More than 25% of the gross sales of the target company are passive income.
- The total tax burden of the income of the target company is less than 10%.
- The gross sale of the target company is more than TL 100,000.

Turkish holding regime tax exemption on capital gains is possible provided the following conditions are fulfilled:

- At least 75% of the assets other than the liquid assets of the company consist of participations in non-resident countries.
- Each subsidiary has at least 10% participation.
- The participation period is more than two years.

Additionally, under the following conditions, the dividend income from non-resident companies is tax-exempt in Turkey:

- Participation is at least 10%.
- The holding period is at least two years.
- There is a total 15% tax on the dividend in the source country.
- The dividend income is transferred to Turkey until the related-year corporate income tax file is submitted.

13. Can the group reorganise after the acquisition in a tax neutral environment through mergers or a tax group?

After an acquisition, a group can reorganise in a tax-neutral manner, but this transaction may have tax results depending on the reorganisation. See “Share deals versus asset deals” above for what to take into consideration in a share deal.

A tax-free merger with another company that is not resident in Turkey is not possible. Also the EU Merger Directive is not applicable since Turkey is not a part of EU.

14. Is there any particular issue to consider in case of companies of which main assets are real estate?

If a Turkish resident company is selling real estate that has held for more than two years, then 75% of the capital gain is exempt from taxation and the remaining 25% is subject to corporate income tax of 20% — that is, the effective tax rate is 5%. To benefit from this exemption, the sale price should not be collected until the end of the second year the sale transaction is realised. Additionally, the exempt amount cannot be distributed for five years, and the seller company should not be in real estate trading activities.

If the holding period is less than two years or the company is in the business of trading real estate, there is 20% taxation on capital gain.

Sell-side

Depending on the nature of the transaction, asset sales can be more taxable in Turkey. Indeed, share sales can even be non-taxable in Turkey, depending on the structure. (See the section “Share deals versus asset deals” from a buyer’s perspective above.)

15. How are capital gains taxed in your country? Is there any participation exemption regime available?

There are no separate capital gains taxations in Turkey, as capital gains tax is part of the corporate income tax base. But there are some exemptions to capital gains tax — see the sections “Share deals versus asset deals” (from the buyer’s perspective) and “Special considerations for companies whose main asset is real estate” above.

16. Is there any fiscal advantage if the proceeds from the sale are reinvested?

Depending on the nature of the transaction, there can be fiscal advantages to reinvesting the proceeds from a sale.

17. Are there any local substance requirements for holding/finance companies?

There are not any local substance requirements, specifically for holding/finance companies.

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