TURKEY

TURKEY

INTERNATIONAL DEVELOPMENTS

1. WHAT ARE RECENT TAX DEVELOPMENTS IN YOUR COUNTRY WHICH ARE RELEVANT FOR M&A DEALS AND PRIVATE EQUITY?

Recently, there are no tax developments in Turkey which are relevant for M&A deals.

2. WHAT IS THE GENERAL APPROACH OF YOUR JURISDICTION REGARDING THE IMPLEMENTATION OF OECD BEPS ACTIONS (ACTION PLANS 6 AND 15 SPECIFICALLY) AND, IF APPLICABLE, THE AMENDMENTS TO THE EU PARENT-SUBSIDIARY DIRECTIVE AND ANTI-TAX AVOIDANCE DIRECTIVES?

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. There are draft changes which have not been published yet.

GENERAL

3. WHAT ARE THE MAIN DIFFERENCES AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS AN ASSET DEAL IN YOUR COUNTRY?

A. 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.

B. 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 2017 is set at TL 1,865,947.

Land and building transfers will be subject to title deed charges at a rate of 1,5%. The basis for the deed is the sale price. Where the sale price is lower than the tax value determined by the municipality, the tax value is the base. Title deed charges should be paid on registration day at the title deed office. The charge is applicable for both buyer and seller, therefore the total rate is 3%.

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 AMORTISATION 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. WHAT ARE THE LIMITATIONS TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS IN THE CASES OF ACQUISITION OF SHARES AND ASSETS?

Effective from 1 January 2013, there are limitations 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 restrictions will be applicable. The rate of the 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, the 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 been incurred until the year- end date of capitalisation (acquisition) must be carried to cost, as provided under the 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 favorable 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 the purchase 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 borrowings 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 borrowings 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.

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 THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

Through Article 8 of Law No: 6637 published in the Official Gazette dated 7 April 2015 and no. 29319, sub-paragraph (ı) has been added to the 10th article of the Corporation Tax Code titled "Other Deductions", and the equity capital companies were introduced the opportunity to deduct one half of the interest calculated over their capital increase in cash from their corporation tax base.

Through the concerned regulation, the general rate of deduction was determined as 50%, and the Council of Ministers was authorised to implement this rate differently based on the provisions stated in the concerned sub-paragraph.

Within this framework, the Council of Ministers has exercised the authorisation bestowed on itself, and has determined the rates of deduction to be applied on capital increases in cash. Through the promulgation of the Council of Ministers numbered 2015/7910 in the Official Gazette dated 30 June 2015 and no 29402, effective as of 1 July 2015, the rate of deduction to be applied on capital increases to be applied pursuant to Article 10/1-ı shall be applied at a rate of 50%.

a) Of the public offering equity capital corporations who benefit from the deduction and who have shares that can be purchased and sold in the stock exchange at the level of Merkezi Kayıt Kuruluşu A.Ş. of whose rate of nominal value corresponding to the paid in or issued capital, shall be implemented by adding the following rates:

- Those that have a rate of 50% or less; plus 25 points
- Those that have a rate of over 50%; plus 50 points.

b) In the event that the capital increased in cash is used in the production and industry facilities with an incentive certificate and in the investments concerning machinery and equipment relating to such facilities, and/or in the investments concerning lands and lots allocated to the construction of these facilities, remaining limited to the fixed investment total stated in the investment incentive certificate; plus 25 points.

On the other hand, the 50% rate of deduction will be applied as follows:

- For the equity capital companies of whose 25% or more of their income consist of passive income such as interest gains, dividend income, rental income, license fees, income from the sale of securities other than commercial, agricultural or independent professional activities through capital, organisation and personnel recruitment: 0%
- For the equity capital companies of whose 50% or higher portion of assets consist of non-current securities, non-current partnerships and participation shares: 0%
- Limited to the portion of the increased capital in cash that has been placed in other companies in cash, or that has been utilised as loans: 0%
- Limited to the portion corresponding to the land and lot investments in the equity capital companies who invest in lands and lots; 0%
- In the event that a capital reduction is performed during the period between 09/03/2015 until 1/7/2015, being the date on which sub paragraph (ı) of the first paragraph of Article 10 of Law no. 5520 is put into effect, limited to the amount of the reduced capital: 0%.

9. 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.

10. ARE THERE ANY ITEMS THAT SHOULD BE INCLUDED IN THE SCOPE OF A TAX DUE DILIGENCE THAT ARE VERY SPECIFIC TO YOUR COUNTRY?

In Turkey limitation period is 5 years. Accordingly all tax declarations related documents should be evaluated for 5 years period.

Additionally especially related party transections as well as receivable/payables to shareholders and cash account with a high balance should be included in the scope of tax due diligence.

11. 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.

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.

12. ARE THERE ANY RESTRICTIONS ON THE CORPORATE TAX DEDUCTIBILITY OF ACQUISITION COSTS?

In principle, there is no restriction on deductibility on acquisition costs related with financial expenses.

13. CAN VAT (IF APPLICABLE) BE RECOVERED ON ACQUISITION COSTS?

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

14. ARE THERE ANY PARTICULAR TAX ISSUES TO CONSIDER IN THE ACQUISITION BY FOREIGN COMPANIES?

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 the 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 regulatory 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.
- There is at least 10% participation in each subsidiary.
- 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.

15. 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 the EU.

16. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

If a Turkish resident company is selling real estate that has been 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 gains.

17. IS FISCAL UNITY/TAX GROUPING ALLOWED IN YOUR JURISDICTION AND IF SO, WHAT BENEFITS DOES IT GRANT?

No, it is not applicable.

SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

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.

19. IS THERE ANY FISCAL ADVANTAGE IF THE PROCEEDS FROM THE SALE OF SHARES ARE REINVESTED?

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

20. ARE THERE ANY LOCAL SUBSTANCE REQUIREMENTS FOR HOLDING COMPANIES?

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

21. ARE THERE ANY SPECIAL TAX CONSIDERATIONS REGARDING MERGERS/SPIN-OFFS?

Merger transactions realised within the conditions set forth in articles 19/1 and 20/1 of Corporate Income Tax Code are exempt from all kinds of taxes. The requirements set forth in the related articles to realise a tax-free merger are;

- Both companies (the transferee company and the transferred company) must be resident in Turkey.
- The transferee company must wholly take over the balance sheet of the transferred corporation as a whole (the assets and liabilities of the two companies shall be consolidated in their entirety in the transferee company).
- A merger tax return shall be submitted to the tax office within 30 days as of the merger date.
- The transferee company shall guarantee the payment of all tax liabilities of the transferred company.

Provided that all of the above requirements are met together, the merger (transfer of the assets and liabilities of the transferred company) will be exempt from following taxes.

Although the profits emerging from the merger operation are not subject to tax, the corporate profits of the dissolved corporation earned during the partial period to lapse from the beginning of the year until the date of the merger shall become subject to corporation tax in a normal manner, and shall be declared through a corporation tax return. If the above mentioned conditions are not met, besides the corporate profits earned until the date of the merger, the dissolved corporation shall be deemed as liquidated, and the profits earned through this liquidation shall also become subject to tax and shall be declared.

- **Corporate Income Tax:** The transfer of all the assets and liabilities from the transferred company to transferee company will be realised at the net book values of the assets and liabilities in the books of the transferred company. Hence, taxable gain or income will not be created as a result of this transfer. Hence, the transfer will be free from corporate income tax.
- **VAT:** According to article 17(4/c) of the Value Added Tax Code, merger transactions that are exempt from corporate income tax are also exempt from VAT. Hence the transfer of assets and liabilities will be free from VAT. The transferee company will be able to utilise the carried forward VATs of the transferred company, if any.
- **Stamp Duty:** All documents issued in relation to a merger transaction, including commercial agreement renewals with the distributors, suppliers, are exempt from stamp tax.
- **Real Estate Transfer Tax:** Real estate transfers in relation to a merger transaction which is exempt from corporate income tax are also exempt from real estate transfer taxes.

As per article 9 of the Corporate Income Tax Code the losses of the transferred company limited with the equity of the transferred company can be deducted from the tax base of the transferee company provided that the following conditions are fulfilled:

- The transferred company should file the corporate income tax declarations in time for the last five years;
- The business of the transferred company should continue in the transferee company at least for five years.

MANAGEMENT INCENTIVES

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

Management incentives are not applicable.

FOR MORE INFORMATION CONTACT:

Saban Erdikler
Turkey
Tel: +90 212 337 00 00
E-mail: saban.erdikler@erdikler.com

Uluc Ozcan
Turkey
Tel: +90 212 337 00 00
E-mail: uluc.ozcan@erdikler.com