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Actual income detection on expanded investments and certain special matters

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In an effort to divert savings towards high value added investments, increase foreign direct investments (FDI), enhance production and employment, to minimize divergences on development, raise international competitive power, support investments with high technology and R&D content; new governmental incentive schemes are introduced continuously. For that purpose, following the removal of investment deduction implementation, through the Law Regarding Amendments on Certain Laws no.5838 dated 28.02.2009 concerning the investment incentive system aimed at enhancing investments, the Article 32/A – Reduced Corporate Tax had been added to the Corporate Tax Law.

Tax deduction, with its simplest definition, means the taxation of income acquired by the investing taxpayers over those investments less by the government under certain rules. In other words, it can be defined as the implementation of corporate tax reduced until the contribution amount predicted for that investment is reached. For this implementation Turkey is separated into six regions and the implementation of reduced corporate tax differs according to the development levels of those regions. On the other side, within the implementation of reduced corporate tax, investment types are divided into two groups in general and in that context, a complete new investment is defined as a newly launched facility while the investments of modernization, integration, product diversification are defined as expanding or renewing a facility existing under the title of expanded investment. Pertaining to that, whether the complete investment or expanded investment will be assessed as a regional, high scale, priority, mid-high tech or strategical investment type would be identified pursuant to the rules indicated in the Council of Ministers Decision no. 2012/3305 dated 19.06.2012.

‘The way that the actual income will be detected and certain special matters concerning the expanded investments’ which are so critical in terms of the implementation of tax deduction, that is the most significant support on investments, are handled within the context of legal regulations. The points to be taken into account during the detection of actual income in expanded investments and the special matters are provided below:

- Defining the income concerning expanded investments finely is of great importance. The income definition here refers to the income groups forming the income statement within General Communique on Accounting Practices series no.1. Those income groups may respectively be outlined as follows: gross sales, net sales, profit or loss from gross sales, operating profit or loss, ordinary profit or loss and profit or loss for the period. The fact that wording of ‘income acquired through the investment refers to the profit before tax is explained within the advance rulings issued by the Revenue Administration. Also, it’s indicated that income and cost equivalents that are not compliant with Tax Procedure Law or calculated by companies according to international accounting standards should not be taken into account while detecting the income from investment. Within that context, in the implementation of reduced corporate tax on expanded investments, taxpayers should concurrently be registering their sales and costs figures concerning expanded investments as they do for other operations. Besides, taxpayers should be making a common income-expenditure distribution while creating their end-term registrations. During that distribution, so as to reach the net profit related to the expanded investment, income should be distributed in line with the revenue share and expenditures should be distributed in line with the cost rates. Such income refers to ordinary and extra-ordinary incomes while expenditures refer to operational costs, ordinary costs, financing costs and extra-ordinary costs.

- As per the Corporate Tax General Communique series no.10, if more than one investment incentive certificate issued under the Decision no.2009/15199 and 2012/3305 exists, the reduced corporate tax will be implemented on the commercial profit figure if the financial profit exceeds the commercial profit; in the circumstance that the financial profit is smaller than the commercial profit, rate of the income acquired separately through each document over the total income acquired through these investments being applied on corporate tax base, reduced corporate tax will be implemented in accordance with the tax deduction rates indicated in these incentive certificates.

- Explanations within the Corporate Tax General Communique series no.10 indicates that the investment period starts from the beginning of the advance tax period comprising the actual initiation date of the investment to the end of the last day of advance tax period that includes the date of application to the Ministry of Economy for the purpose of completion visa. On the other hand, in the circumstance that the actual finalization date of the investment corresponds to an advance tax period prior to application date to the Ministry of Economy, the last day of the advance tax period comprising the investment's finalization date must be considered as the date that the investment period ends. Operational period may be defined as the completion of investment while partial operation period refers to the investment's starting operations partly not completely. On the other side, through the wording added as the sub-clause c to the Article 32/A of Corporate Tax Law and Article 39 of the Law no.6322, as of 01.01.2013, implementation of reduced corporate tax would be applied over the taxpayers' other income during investment period. Pertaining to that, provided that they meet the required conditions, other income of them may also be subject to reduced corporate tax during the investment period.

- Within the scope of Corporate Tax General Communique series no.10, in the circumstance that the taxpayers have more than one incentive certificate issued under the Decision no. 2012/3305 and income acquired from other activities during the investment period is not sufficient, the taxpayer will be able to freely choose the incentive certificate which would be given priority. Within that context, if reduced corporate tax is applied over an investment with more than one incentive certificate; income from each investment should be identified separately, their own reduced tax rate should be applied on each of them and own contribution amount must be applied for each incentive certificate.

- In case one investment is utilized within another investment, in other words, if decomposition is not available in terms of implementing reduced corporate tax on expanded investments handled with the purpose of model change, modernization, capacity increase, in an advanced ruling issued in relation to whether the unused contribution amounts within existing incentive certificate will be carried on using and if carried on using, the way how it should be calculated, it's indicated that "in a production facility, in case fixed assets that are included both in the existing investment certificate and the new incentive certificate are used, in the circumstance that income concerning each incentive certificate cannot be calculated separately, decomposition may be applied over the income acquired through this production facility by proportioning fixed assets under each incentive certificate used in production to the total fixed assets used in production.

- Financing costs concerning the loan for investment, which have to be capitalized, should be included in the contribution amount.

- Equivalents for income and expenditures contrary to Tax Procedure Law should not be taken into account in detection of investment income.

- Shares allocated to buildings from lands used in investment should be subject to depreciation, however they should not be included in the contribution amount.

- Fields, lands, royalty, spare parts and other expenditures that are not subject to depreciation should not be taken into account in terms of the contribution amount.

- Amounts from the completed investments that are unused and transferred to other years could be raised through revaluation rate.

Consequently, within the implementation of reduced corporate tax on expanded investments; although a resolution seems to be reached through applying proportioning over fixed assets, those proportioning methods may prove disadvantageous for taxpayers. In that case, for the taxpayers' turning the situation advantageous for themselves, manufacturing, operational and accounting systems used should be designed so as to provide opportunity for actual detection of income from expanded investments.

In our view, during the implementation of reduced corporate tax on expanded investments, detection of the actual income acquired from these investments exactly will be the most appropriate solution both for proper functioning of this system and also for avoiding taxation risks that may arise.

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