

Application of financing expense restriction in terms of corporate taxpayers

In accordance with the financing expense restriction, it will not be accepted to deduct the portion of the expense determined by the President as an expense, provided that it does not exceed 10% of the sum of expenses and cost elements made under the names of interest, commission, maturity difference, dividend, exchange difference and similar items related to foreign resources within the scope of the specified criteria. The President determined the said rate as 10% to be applied to the taxation period earnings starting from 1.1.2021 with the President's Decree dated 3 February 2021 and numbered 3490, published in the Official Gazette dated February 4, 2021.

Specific cases regarding financing expense restriction shall be included in this letter.

Communique of Turkish Revenue Administration with respect to financing expense restriction

Initial Draft Communique published by Turkish Revenue Administration on 24.03.2021 was updated based on incoming opinions and implementation procedures have been established through publishing serial no. 18 Draft Communique. At this point, we would like to state that the Communique in question is still a draft as of date of our letter.

Covered and uncovered taxpayers

All corporate taxpayers of which foreign resources exceeding their equities and which are subject to balance sheet basis are subject to financing expense restriction application except for taxpayers mentioned in the text of Law.

The following entities are not subject to financing expense restriction.

- Credit institutions,
- Financial institutions,
- Financial leasing companies,
- Factoring companies,
- Financing companies.

Foreign resources to be taken into account in scope of the application

Foreign resources are explained as “total short-term liabilities and long-term liabilities of the balance sheet” in the Draft Communique published by Turkish Revenue Administration.

In this context, total of “3. Short Term Liabilities” and “4. Long Term Liabilities” shall be taken into account as foreign resources in practice according to Uniform Chart of Accounts of taxpayers.

Expense and cost items to be taken into account in scope of application

In accordance with the Law, expenses and costs incurred under the names of interest, commission, maturity difference, dividend, exchange difference and similar names

regarding the foreign resources used in the entity will be taken into account in the application of the financing expense restriction. As a general principle, in order for an expense or cost element to be taken into account in the application of financing expense restriction, this expense or cost element must have arisen due to the use of foreign resources and the duration of use of this resource.

However, those that are added to the cost of the investment (including the amounts monitored in the "Construction in progress" account) of the cost of the economic assets subject to depreciation (with or without incentive certificate) will not be taken into account in the application of financial expense restriction.

In the light of above explanations, it will be possible to summarize the expenses and cost elements subject to financial expense restriction as follows;

- All kinds of interests and commissions
- Maturity differences
- Dividends
- Exchange differences
- Interest paid to financial leasing companies and not added to the cost of fixed assets on a voluntary basis
- Financial expenses, which are not added to the investment cost, but are directly recognized as an expense, in economic assets that are subject to depreciation with or without incentive.
- Financing expenses incurred due to manufactured or purchased commodities (whether they are transferred to cost or recognized directly within the framework of Serial No. 238 General Communiqué on TPL)
- Interest expenses related to loans made available by the group company.

Foreign resources not used at the entity

In order for the expenses related to the foreign resources provided by an entity to be subject to expense restriction, the use of the said resource within the enterprise is a requirement in accordance with the text of the Law. Therefore, if, for example, loans obtained by enterprises from institutions such as banks are transferred to group companies without any financial burden, a foreign resource used in the entity will not be mentioned within the enterprise providing these loans from the bank and there will be no actual financial expense. Therefore, interest paid to the bank by the business in question should not be considered under the financing expense restriction. On the other hand, it is natural that the entity to whom the loan is transferred will consider the financing expenses incurred for this loan in the application of the financing expense restriction.

Position of financing income in scope of the application

Considering that the aforementioned application is in nature of an expense restriction, it is not possible for taxpayers, which have obtained financing income as well as financing expenses, to net off the said income and expenses by comparing them with each other in the application of expense restriction.

Position of exchange difference in scope of the application

Exchange difference expenses that do not depend on the use of foreign resources (for example, related to money in banks, trade receivables, advances given) will not be considered within the scope of the financing expense restriction.

According to the explanations in the relevant part of the Draft Communiqué, the net amount of the foreign exchange difference income and expense amounts in the relevant period regarding the same foreign resource as of the balance sheet date to be taken into account in the application of financing expense restriction will be considered within the scope of the expense restriction application.

Balance sheets to be taken into account in terms of financing expense restriction calculations and method of calculation

Corporate taxpayers which are within the scope of the expense restriction and keep their books on the basis of the balance sheet, while determining whether they will be subject to financial expense restriction, should make a comparison of equity and foreign resources based on the balance sheets they will issue according to the Tax Procedure Law as of the last day of each advance tax period.

10% of the financing expenses, corresponding to the part exceeding the equity of the foreign resources calculated as a result of the said comparison, will be considered as non-deductible expense.

Financing expense restriction application in terms of taxpayers carrying out construction and repair works extending to years

In the construction and repair works, the profit or loss is determined exactly in the year the work is completed and all of them are taxed as the income of that year. Since the financing expenses related to the foreign resources used by those who are carrying out these works should be taken into account as an expense or cost item in the calculation of the income of the year in which the final profit or loss of the business is determined, the application regarding the expense restriction should also be made in the same period.

Position of financing expenses which are taken into account as non-deductible expense within expense restriction for passenger cars, disguised profit distribution through transfer pricing and thin capitalization

Financial expenses which are taken into account as non-deductible expense within thin capitalization, disguised profit distribution through transfer pricing and expense restriction for passenger cars shall be deducted from financial expenses during the calculation of financing expense restriction application.

Financing expense restriction in ordinary partnerships

It is mentioned in the Draft Communiqué that for ordinary partnerships of which foreign resources exceed their equities in its balance sheet, 10% of total expense and cost items (except included in the cost of investments) calculated for the exceeding portion, made under interest, commission, maturity difference, dividend, exchange differences and similar names related to foreign resources used in entities, shall be taken into account as

non-deductible expense by shareholders (in the ratio of their partnership) of these partnerships.

Evaluation of loans received before the effective date of the Law in scope of financing expense restriction

It is stipulated under Draft Communiqué that article of the Law related to financing expense restriction has entered into force as of 1.1.2013 and financing expenses arising due to financing services or loan agreements rendered/made as of aforementioned date (including this date) are in scope of restriction in order to be applicable for taxation periods starting as of 1.1.2021.

Explanations in this article reflect the writer's personal view on the matter. EY and/or Kuzey YMM ve Bağımsız Denetim A.Ş. disclaim any responsibility in respect of the information and explanations in the article. Please be advised to first receive professional assistance from the related experts before initiating an application regarding a specific matter, since the legislation is changed frequently and is open to different interpretations.