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Turkish President Ratifies Tax Reform Law

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Release Date: APRIL 14, 2006Turkish President Ahmet Necdet Sezer has ratified a law that terminates Turkey's long-standing investment incentive allowance, establishes new personal income tax rates, and amends the penalty for late payment or failure to pay taxes, among other things. Law 5,479 was published in the official gazette of April 8. Its provisions regarding the investment incentive allowance and the new income tax rates have retroactive effect from January 1, 2006. (For prior coverage, see Tax Notes Int'l, Jan. 9, 2006, p. 112.)

Investment Incentive Allowance

The investment incentive allowance provided for the deduction of investment expenditures from individual and corporate taxpayers' declared income from those investments.

Law 4,842 of April 24, 2003, introduced a bilateral system whereby the investment allowance rate varied from 40 percent to 200 percent of expenditure, according to the type and place of the investment. The previous 19.8 percent withholding tax on income exceeding the investment allowance was abolished, but a dividend withholding tax was due when profits were distributed to individual and corporate shareholders resident abroad. Any extension of the investment allowance from previous applications was limited to 40 percent. (For prior coverage, see Tax Notes Int'l, June 23, 2003, p. 1193.)

Transition Period

Under new Law 5,479, the investment incentive allowance has been terminated. However, a temporary article 69 inserted into the Income Tax Code provides that investment expenditures that are nondeductible as of the end of 2005 because of insufficient profits may continue to be deducted until the end of 2008 under the same conditions as provided in the bilateral system introduced by Law 4,842. The investment incentive allowance cannot be used for investment expenditures initiated on or after January 1, 2006. However, temporary article 69 establishes a transitional period of three years for investments previously subject to the tax exemption under the investment allowance.

Because the bilateral system will continue to apply through 2008 for expenditures incurred by taxpayers through December 31, 2005, the following rules will apply:

- Investment incentive allowances based on investment certificates issued before April 24, 2003, will – for profits generated in 2006 and following years until December 31, 2008 — be subject to withholding tax at the rate of 19.8 percent. However, it may be possible to apply a reduced tax rate because of the provisions of a tax treaty with Turkey.

- Investment incentive allowances based on investment certificates issued between April 24, 2003, and December 31, 2005, will — for profits generated in 2006 and following years until December 31, 2008 — not be subject to the withholding tax. This rule also applies to uncertified investment expenditures incurred during the same period.

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- For corporate taxpayers benefiting from the investment incentive allowance in 2006 and following years (until the end of 2008), the corporate tax base that exceeds the investment incentive allowance for the same period will be subject to corporate tax at a rate of 30 percent, and not the 20 percent rate applicable from January 1, 2006, under the new corporate tax code that is expected to be implemented in the near future.

For example, a taxpayer with corporate income amounting to TRY 100 for fiscal 2006 and a deferred investment incentive allowance amounting to TRY 50 should declare a TRY 50 corporate tax base and pay TRY 15 (TRY 50 multiplied by 30 percent) in corporate tax for fiscal 2006. Because the taxpayer will not have a deferred investment incentive allowance when calculating its corporate tax base for fiscal 2007 and 2008, the corporate income for those fiscal years would be subject to corporate tax at the reduced rate (20 percent).

Criticism of Transitional Regulations

Under the Turkish Constitution, either the president or the main opposition party has a right to appeal to the Constitutional Court any provisions of the new law that are considered unconstitutional. Turkish tax practitioners expect that some provisions of the transitional regulations for the investment incentive allowance, such as the three-year transition period and the application of the 30 percent corporate tax rate, may be appealed before the Constitutional Court based on grandfathering provisions.

New Personal Income Tax Rates

The new personal income tax rates are as follows:

- for income up to TRY 7,000 — 15 percent;
- for income of TRY 7,001 to TRY 18,000 — 20 percent;
- for income of TRY 18,001 and TRY 40,000 — 27 percent; and
- for income of TRY 40,001 and above — 35 percent.

Other Provisions

Law 5,479 also increases the penalty for late payment or failure to pay taxes so that the penalty now is equal to the amount of the unpaid tax. It also redetermined special consumption tax rates applicable to some goods, such as alcoholic beverages and tobacco products. Also, biodiesel has been added to the list of fuels subject to the special consumption tax.

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