

# INTERNATIONAL TAX SERVICES

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## FOREIGN DESK ALERT

### New Turkish Withholding Tax Rates Announced; Corporate Rate Amended

#### Executive Summary

Turkey's long-awaited withholding tax rate changes were announced on August 25, 1999. As a result, the Turkish corporate income tax rate in the case of a distribution will be 44.055 percent. Further, the withholding tax on repo (sale or purchase of securities with an agreement to re-purchase or sale) transactions is increased to 13.2 percent (formerly 6 percent) and the withholding tax on time-deposit interest is increased to 14.3 percent (formerly 12 percent).

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#### Detailed Discussion

##### Corporate Income Tax Rate

Turkey's corporate income tax ("CIT") calculation method and the tax rate were changed beginning January 1, 1999. Under the new system, the CIT rate was increased to 30 percent (formerly 25 percent). Further, the former two-tier tax system with "imputation credit" was amended into a partial relief system at the shareholder level. Accordingly, an income tax withholding ("ITWH") is levied at the corporate level if a Turkish company makes a distribution to its shareholders. The relevant

section of the code authorizes the Council of Ministers to determine the ITWH rate. Due to early elections and the formation of a new coalition government, the announcement of the ITWH rates was delayed until August 25, 1999. ITWH will be levied at a rate of 5.5 percent (formerly 11 percent) when a dividend distribution is made by a Turkish stock exchange quoted company. In all other cases, the ITWH rate will be 16.5 percent (formerly 22 percent) when a dividend distribution is made.

Accordingly, the total CIT rate (in the case of a dividend distribution) will be 44.055 percent for a non-stock exchange quoted company. Otherwise, the CIT rate will be 33 percent. The calculation will be as follows:

100	Gross income	a
30	CIT (30% x a)	b
3	CIT surcharge (10% x b)	c
67	ITWH base (a-(b+c))	d
10.05	ITWH (15% x d)	e
1.005	ITWH surcharge (10% x e)	f
44.055	Total tax liability (b+d+e+f)	

The total CIT rate (in the case of a dividend distribution) will be 36.685 percent for a stock exchange quoted company.

100	Gross income	a
30	CIT (30% x a)	b
3	CIT surcharge (10% x b)	c
67	ITWH base (a-(b+c))	d
3.35	ITWH (5% x d)	e
0.335	ITWH surcharge (10% x e)	f
36.685	Total tax liability (b+d+e+f)	

ITWH rates may be reduced under various tax treaties concluded by Turkey that provide a lower rate for dividend withholding tax. For instance, under the Netherlands-Turkey treaty, the ITWH rate is reduced from 16.5 percent to 10 percent provided certain conditions are met. Therefore, the aggregate CIT burden on the corporate income of a Turkish entity will be 39.70 percent (as opposed to the 44.055-percent rate in a non-treaty situation). The total rate is 43.05 percent under the new U.S.-Turkey tax treaty (see below).

The new CIT rates under the listed treaties for a subsidiary will be as follows:

Country where parent is resident	Aggregate CIT rate
Non-treaty rate	44.055%
The Netherlands	39.70%
United States	43.05%
France	43.05%
United Kingdom	43.05%
Italy	43.05%
Germany	43.05%

The new CIT rates under the listed treaties for a branch will be as follows:

Country where parent is resident	Aggregate CIT rate
Non-treaty rate	44.055%
The Netherlands	38.025%
United States	43.05%
France	43.05%
United Kingdom	43.05%
Italy	43.05%
Germany	43.05%

### **Repo/time Deposit Interest Withholding Tax Rates**

The rate of withholding tax on repo transactions is increased from 6.6 percent to 13.2 percent (including a 10-percent fiscal surcharge). Under a “repo” transaction, a bank or a financial institution sells the debt security to the investor while arranging at the same time to repurchase the security on a given date for a given price. The transaction may be arranged for a sale of the debt security which was originally held by the investor (i.e., reverse repo). If an investor disposes of a Turkish debt security before its maturity date through a repo contract the income received (the repo rate plus the interest) is considered repo income. In principle, benefits derived from the acquisition or disposal of state bonds or Treasury bills issued after January 1, 1999, under a repurchase or resale agreement (i.e., repo/reverse repo) were subject to withholding tax at a reduced rate of 6.6

percent (with a 10-percent surcharge). This rate is increased to 13.2 percent for repo/reverse repo transactions that are concluded after September 1, 1999. Thus, if an investor enters into a secured lending agreement or a reverse repo agreement with Turkish counterparties, the Turkish withholding tax on both the repo rate and the interest over this income will be 13.2 percent (with a 10-percent surcharge) if the repo contract is made after September 1, 1999. The tax will be 6.6 percent (with 10 percent surcharge) if the repo contract is made before this date.

Similarly, the rate of withholding tax on time deposit interest and foreign currency deposit interest is also increased from 13.2 percent to 14.3 percent. The new withholding tax rate on the interest income will apply to interest income received from these deposits beginning September 1, 1999.

### **Withholding Tax on Exempt Income**

Investments qualifying for an investment certificate (which are therefore considered specially encouraged investments under the Turkish investment encouragement program) benefit from an investment allowance for corporate income tax purposes. The

allowance amount is deducted from the corporate income tax base. This can be seen as a dual amortization of the same asset -- once as an investment allowance and again as the normal depreciation of fixed assets.

Nevertheless, the amount that was used as an investment allowance was subject to alternative (withholding) tax. In other words, even if a corporation benefits from the investment allowance (so that no CIT and ITWH is due, provided the allowance amount is higher than the CIT base in that year), the corporation is still subject to alternative (withholding) tax. The base of the tax is equal to the investment allowance deducted from the corporate income tax base. The rate of this alternative (withholding) tax is 16.5 percent (with a 10-percent surcharge). In practical terms, by benefiting from the investment allowance scheme, a company used to pay a 16.5-percent effective tax rate on its corporate earnings, instead of the statutory 44.055-percent rate.

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