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Turkey: 2004 Year in Review

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Turkey in 2004 continued to try to transform the country's tax laws into a system that more closely follows EU and OECD standards. The tax system has suffered from chronic problems in recent years, including a heavy dependence on indirect taxes and the large informal economy. As a result, more taxpayers are now complaining about high income tax and VAT rates and heavy compliance costs. The amendments introduced in 2004 sought to offer solutions to some of those problems, but a few of the new measures brought additional difficulties for taxpayers. This article summarizes the most significant tax developments in Turkey for the past year.

Accounting for Inflation

Inflation accounting was introduced with the Turkish Parliament's ratification of Law 5024 on December 18, 2003. The system acknowledges the adjustment of nonmonetary items found in the balance sheet, with the retail price index (RPI) between the balance sheet date and the booking date of assets or liabilities. Inflation accounting also determines new regulations for the depreciation of fixed assets. According to the regulations, fixed assets acquired from January 1, 2004, will be subject to depreciation in conformity with economic life tables as determined by the Ministry of Finance.

The system is mandatory for all companies established in Turkey that keep their books according to the balance sheet method. Some companies that operate under limitations in total assets and turnover are allowed to apply inflation accounting from December 31, 2004. Other companies have applied inflation accounting rules for their balance sheets as of December 31, 2003, but those adjustments were not considered for the calculation of the corporate tax base for 2003.

To apply inflation accounting for a specific period, the increase in the RPI must exceed 10 percent for the last 12 months and 100 percent for the last 36 months. In the second and third quarters of calendar year 2003, those conditions have been realized and inflation accounting has been applied. The adjustments had effects on the advance corporate tax bases of companies.

Law 5035

Law 5035, as published in the official gazette on January 2, 2004, introduced some of the more important tax amendments for 2004. The amendments are summarized below:

- The corporate income tax rate was set at 33 percent.
- The calculation method for the motor vehicles tax was changed from a weight-based criteria to a volume-based criteria.
- Customer financing agreements have been exempted from the stamp tax.

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- Some temporary articles were made applicable for 2004, including an exemption for interest income derived from treasury bonds and government bonds; an exemption for time deposit income and repurchase income subjected to withholding; and an exemption for income from the sale of real estate and share stocks by resident companies, provided the income has been added to the capital of the company in the year the sale was realized.

- The submission and payment dates for some taxes have been changed. Income and corporate tax returns must be submitted to the tax offices by March 15 and April 15, respectively, and paid by the last day of the corresponding month; withholding and VAT returns must be submitted by the 20th day of the following month, and paid by the 26th day of that month.

Free Trade Zone

Law 5084, published in the official gazette on February 6, 2004, made important amendments to the tax advantages for companies established in Turkey's free trade zones. According to the amendments, income from activities in those zones is exempt from income tax and corporate tax until the date determined in the "activity certificates." Transactions for activities conducted in the zones are exempt from assorted tax and duties until December 31, 2008.

The amendments also provide that the exemptions for income tax and corporate tax apply until the date Turkey becomes a full member of the European Union. The Ministry of Finance published a communique on September 6 determining the scope of tax-exempt income for activities in free trade zones and other issues, including bookkeeping procedures and withholding taxes.

Other Provisions

The government on February 29 published a Council of Ministers Decision lowering the VAT rate applied on pharmaceuticals certified by the Ministry of Health from 18 percent to 8 percent.

A communique published in June explained the regulations related to the sponsorship of companies with amateur and professional sports organizations. Qualifying sponsorship expenditures will be fully tax deductible for amateur branches. For professional branches, the deduction is limited to 50 percent of the expense.

Law 5228

Law 5228 stipulated that companies may keep their tax records in a language other than Turkish and in a currency other than the Turkish lira provided parallel records are maintained in the Turkish language and using the lira. Companies with a paid capital account of at least US $ 100 million and a foreign ownership of at least 40 percent may be allowed to keep their records in a different currency by the permission of the Council of Ministers.

The new measure also provided that dividend income received by Turkish companies from their foreign subsidiaries, and income from permanent establishments located abroad, are exempt from corporate tax under special conditions.

New regulations have been introduced regarding the establishment of international holding companies in Turkey. Income received by resident joint stock companies from participations in nonresident subsidiaries should be exempt from corporate tax. Also, dividends paid by the Turkish holding companies over their tax-exempt income to shareholders with the status of a joint stock company or limited liability company will be subject to a withholding tax rate of 5 percent.

The New Turkish Lira

A final important amendment in 2004 was the introduction of the new Turkish lira. Law 5083, published in the official gazette in January, stipulated that the new Turkish lira will be in circulation starting from January 1, 2005. The Ministry of Finance on June 10 published a communique explaining the use of the new lira in accounting systems of private and public companies. One new Turkish lira will equal one million old Turkish liras. Both old bank notes and new bank notes will be in circulation during 2005.

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