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Draft Turkish Tax Law Would Improve International Competitiveness

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The Turkish government has sent a draft tax law to Parliament for review and approval. The draft includes 58 articles and seeks to improve Turkey's competitiveness in the international business community. Highlights of the draft are summarized below.

Foreign Dividends and Branch Profits

The most controversial article in the draft is related to the exemption to be applied on foreign dividends and branch profits. The article would enable Turkish corporate taxpayers to claim a full tax exemption on foreign dividends and branch profits without any requirement. Therefore, active or passive, offshore income, or any income, would not be taxable if the dividends or branch profits were transferred into the country by the end of 2005.

Participation Exemption

The draft introduces for the first time a participation exemption on dividend and branch income arising from overseas activities. Under the new regime, a Turkish company would be able to claim a participation exemption on dividends or branch profit under the following conditions:

! the activity field of the subsidiary or branch must be commercial, industrial, agricultural, or service- oriented;

! financial leasing activities and portfolio investment activities are beyond the scope of the exemption;

! there would be a minimum two-year holding requirement for the participations;

! the minimum shareholding percentage would be 25 percent;

! foreign income would be taxed in the host country at a minimum rate of 20 percent; and

! the foreign income must include at least 75 percent active income (commercial income).

Apart from conditions stated above, a Turkish holding company would be able to claim participation exemption under the following conditions:

! A Turkish holding company's assets must include at least 75 percent of participations resident abroad.

! There must be a minimum 25 percent participation.

! Participation income (dividends) must form at least 75 percent of the total holding company income.

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- Foreign income would be subject to corporate tax at a minimum rate of 20 percent. If the host country tax is between 19.99 and 15 percent, the exemption would be applied on 50 percent of the income. If the rate is between 14.99 and 10 percent, the exemption part of the income would be one-third of the total income.

- The dividends distributed by qualified Turkish holding companies would be subject to 5 percent dividend withholding tax, including dividends remitted to shareholders resident in tax havens. The new holding regime targets multinationals operating in the Balkans, Central Asia, and the Middle East, where Turkey has significant economic advantages.

Under the draft a Turkish holding company would offer a full tax advantage plus a very low 5 percent withholding tax on dividends to be remitted anywhere.

Special Tax Incentives

The government has withdrawn the tax holiday application from the draft. Instead, an increased investment allowance (normally 40 percent) would be introduced for special investments. Under the draft, the investments exceeding TRL 50 trillion (approximately US $ 33 million) would be able to claim an increased investment allowance rate up to 80 percent. For agricultural investments, the minimum investment amount to be considered would be one-quarter of the original number (around US $ 8 million).

Under the new incentive regime, the taxpayer would be able to deduct 1.8 times the total investment from the tax base, and 0.8 times the total investment would be deductible immediately upon the realization of the investment (cash basis).

Mining Activities

Under the draft, deliveries and services made to the precious metal (gold, silver, and platinum) mining enterprises would be exempt from VAT. The exemption would decrease the cost of those enterprises by 18 percent.

Research and Development Incentives

R&D expenses would be deductible at 1.4 times the original expense amount under the draft.

Exemption for Education Enterprises

The draft would allow a five-year tax holiday for education enterprises. The exemption would help remedy Turkey's education problem for the younger population, as Turkey has a large young population and only a 1 to 2 percent education budget.

Tax Amnesty for Irregularity Penalties

The draft would allow for a limited tax amnesty for taxpayers that were subject to the penalties related to the documentation (invoice) rules. These penalties vary from forced closing of the business place for a period of time to imposed fines. Under the draft all the penalties would be removed for past offenses.

Bookkeeping in Foreign Currency

The draft includes a dramatic change under which the taxpayers whose shareholders (minimum 40 percent holding) or owners are nonresidents would be allowed to keep their legal books in foreign currency on the condition that the capital of the enterprise is at least US $ 100 million. Permission must be granted by a government decree. The taxpayers permitted to use this application must declare their tax base in accordance with foreign currency bookkeeping financial results. Therefore, there would be no inflation adjustment for those taxpayers, which would be the case for books kept in Turkish lira.

Internet Tax Return Filings

Under the draft taxpayers would be able to file their tax returns through the Ministry of Finance Web site.

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