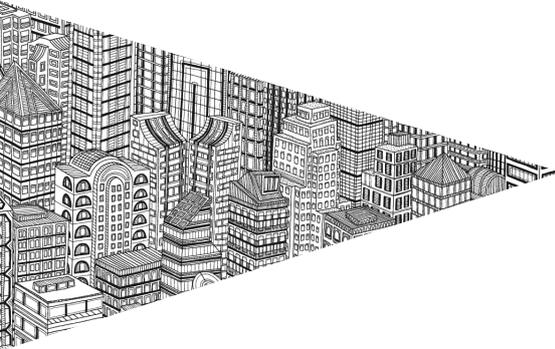


International Tax Alert



Turkish Constitutional Court rules income tax law provision regulating deductibility of certain investment allowances is unconstitutional

On 15 October 2009, the Constitutional Court of Turkey decided to cancel the income tax law provision which limited the time period for benefiting from carried forward investment allowances not used as of 31 December 2005, until the end of 2008, finding this law provision inconsistent with the Turkish Constitution.

Background on investment allowance application

In Turkey, the investment allowance application was in force before the enactment of Law No 5479, which became effective on 8 April 2006. In broad terms, the investment allowance was an application which allowed companies to deduct a determined portion of their current year capital expenditures from the corporate tax base of that account year. If the current year profit was not sufficient to deduct the investment allowance, then it could be deducted until the whole investment amount was deducted totally.

According to prior legislation before Law No 5479, taxpayers were given two choices for investment allowance application:

1. Companies that had non-deducted investment allowances as of 24 April 2003, which were related to investments made within the scope of an investment certificate before 24 April 2003 had the option to benefit from an investment allowance for these amounts, with varying rates ranging from 40% to 200% of the total amount of investment, depending on the region in which the investment was made and

the sector of the company. However, for these companies, withholding tax of 19.8% was applied on the amount of the benefitted investment allowance.

2. Companies were also able to benefit from the 40% investment allowance for capital expenditures they made after 24 April 2003 (i.e., able to deduct 40% of the new assets they acquired for their activities) and no withholding taxes would apply on the investment allowances from which they would have benefited.

Law no 5479, Article 19 of the Income Tax Law, which regulated the investment allowance practice, was terminated as of 1 January 2006. However, the same law added temporary article 69 to the Income Tax Law, granting a grandfathering period for Turkish companies that had completed their investments before Law No 5479 came into force and had investment allowances which they were not able to deduct from their profits in periods before 2006. Under this article, such taxpayers

were granted the right to deduct their existing (carried forward) investment allowances from corporate profits for the 2006, 2007 and 2008 years. However, if any carried forward investment allowance amounts as of 31 December 2005 were not able to be deducted in this period due to insufficient corporate profits in years 2006, 2007 and 2008, then these taxpayers would not be able to deduct those remaining amounts from the profits of years after 2008.

The decision of the Constitutional Court and its implications

On 15 October 2009, the Turkish Constitutional Court ruled to annul the income tax law provision which required that carried forward investment allowances as of 31 December 2005 could only be deducted from corporate profits for the years 2006, 2007 and 2008. The Court found the provision to be inconsistent with the Turkish Constitution.

The decision of the Constitutional Court means that the time limit for the use of investment allowances

only for the years 2006, 2007 and 2008 is abolished and taxpayers will be able to deduct the carried forward investment allowances without any time limits when the decision of the Constitutional Court becomes effective upon publication in the Official Gazette.

Since the annulment decision will be effective after publication in the Official Gazette, the time limitation on the investment allowance will be effective until that date. Therefore, until the annulment decision is published in the Official Gazette, it would be beneficial for taxpayers to declare their corporate income tax returns (on which they would not be able to benefit from investment allowances) "with reservation." This allows taxpayers to open court cases against the applications made in line with their own declarations on their tax returns. In this way, taxpayers would be able to apply to the court to benefit from the investment allowances for the periods for which they had submitted their tax returns with reservation, requesting to benefit from these investment allowances.

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