INTERNATIONAL
TAX SERVICES

JUNE 26, 2003

ITS in the News

ERNST & YOUNG
Quality In Everything We Do

Turkish Officials Rewrite Tax Rules for Corporate Profits, Dividend Income

*by Mustafa Camlica, Ernst & Young Istanbul**

Law 4842, ratified by Turkey's Grand National Assembly in April, introduced a number of significant amendments to the tax regime for corporate profits and dividend income. Specifically, corporation tax and income tax have been fully integrated, and the tax burden on distributed company profits has been significantly reduced.

In light of those changes, companies established with local capital would be wise to review their dividend distribution policies and readjust their approach to the distribution of dividends in cash.

The main tax amendments introduced by the new law can be summarized as follows:

- The exemption withholding, a sort of minimum corporate tax on investment allowances and similar exemptions, has been repealed.
- Through Council of Ministers Resolution 2003/ 5590, the withholding rate, which was 5.5 percent on publicly held corporations and 16.5 percent on nonpublic corporations, was converted to a flat rate of 11 percent, effective from 24 April 2003. Meanwhile, consequent to the abolition of the fund levies (see below), the dividend withholding rate will be reduced to 10 percent, effective 1 January 2004.
- Dividends distributed to resident corporations and nonresident corporations that have a permanent representative or a permanent establishment in Turkey have been excluded from the scope of dividend withholding. Previously, the dividend withholding applied to the distribution of all types of dividends.
- The tax credit, calculated at a proportion of one- fifth of the dividends, has been repealed.
- Half of the dividend income derived by real persons from corporations has been exempted from income tax, and if such dividend income is declared, the taxpayer now can deduct the withholding tax calculated at the corporate level.
- Dividends of less than TRL 12 billion do not have to be declared.
- The 10 percent fund levies applied on both income taxes and corporation taxes, and on income tax and corporation withholdings, have been repealed, effective 1 January 2004.

Although the increase of the dividend withholding rate from 5.5 percent to 11 percent for publicly held corporations appears at first glance to have negative implications, the amendments to the

This article originally appeared in the June 2, 2003 issue of *Tax Notes International*, p. 866, volume 30.

taxation of the dividends at the level of the real person (shareholder) provide a different perspective. The tables below illustrate the differences between the old and new tax regimes for corporate profits and dividends, for both public and nonpublic corporations.

Old System (in lira)

	Public	Nonpublic
Corporate Profits	100	100
Corporation Tax (Including Fund Levy) (33%)	33	33
Distributable Profit	67	67
Dividend Withholding (Including Fund Levy) (5.5% to 16.5%)	3.69	11.06
Net Dividends	63.32	55.95
Tax Credit (1/5)	12.66	11.19
Dividends to Be Declared	75.98	67.13
Income Tax (49.5%)	37.61	33.23
Deductible Tax Credit (Including Fund Levy)	-13.93	-12.31
Additional Income Tax to Be Paid	23.68	20.92
Total Tax Burden	60.36	64.98

New System (in lira)

	Public/Nonpublic
Corporate Profits	100
Corporation Tax (Including Fund Levy) (30%)	30
Distributable Profit	70
Dividend Withholding (10%)	7
Net Dividends	63
Exempted Dividends (50%)	-35
Dividends to Be Declared	35
Income Tax (45%)	15.75
Withholding to Be Offset	-7
Additional Income Tax to Be Paid	8.75
Total Tax Burden	45.75

Because the fund levy will be repealed as of 1 January 2004, the effective tax rate used under the new system in the above calculations is 45 percent (the highest income tax rate), while the effective rate used under the old system is 49.5 percent.

Corporations that previously eschewed cash dividend distributions are expected to revise their policies in that regard because of the substantial tax relief introduced by the amendments to Law 4842. The withholding exemption for dividends distributed to resident taxpayers likely will add a further impetus to that trend.

ERNST & YOUNG LLP

www.ey.com

For additional information regarding this *ITS in the News*, please contact the following:

E&Y Istanbul

Mustafa Camlica Mustafa.Camlica@tr.ey.com

International Tax Services

Global ITS
Jim Tobin, *New York*

Australia
Michael Johnston, *Sydney*

Belgium
Herwig Joosten, *Brussels*

Canada
Allan Lanthier, *Montreal*

France
Robert Tarika, *Paris*

Germany
Manfred Burkert, *Hamburg*

Ireland
Eamonn O'Doherty, *Dublin*

Italy
Carlo Gnetti, *Milan*

Latin America
Manuel Solano, *New York*

Luxembourg
Marc Schmitz, *Luxembourg*

Netherlands
Ton van den Hoven, *Rotterdam*

Singapore
Lisa Lim, *Singapore*

Spain
Juan José Terraza, *Barcelona*

Sweden
Lars-Peter Ekelund, *Stockholm*

Switzerland
Markus F. Huber, *Zurich*

United Kingdom
Ken MacKenzie, *London*

United States
Scott Hill, *New York*