INTERNATIONAL TAX SERVICES

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This International Tax Services Alert was prepared by the International Tax Services Group to present a time-sensitive development affecting our clients.

FOREIGN DESK ALERT

Recent Changes in Turkish Tax Laws

Executive Summary

As part of the austerity measures introduced by the government, the Turkish Grand National Assembly on August 11, 1999, adopted a Tax Act that amends various articles of Turkish tax laws.

The aim of the new rules is to reduce the tax burden on corporate taxpayers through the easing of the provisional corporate income tax rules, as well as extending the application period of tax-free asset/stock sale and/or asset/stock exchanges (with a tax-free step-up facility).

Further, the tax burden on certain individual income categories is reduced to assist in the recovery of capital market products and banks. These changes are discussed below.

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Detailed Discussion

<u>Advance Corporate Income Tax</u>

Since January 1, 1999, a Turkish company has been required to make quarterly corporate income tax payments for its current year tax liability as an Advance Corporation Income Tax (ACT), or so-called "provisional tax." The quarterly periods are January-March, April-June, July-September, and October-December. During the course of 1999, a Turkish company is required to pay 25% of its taxable income for each quarter as ACT to the tax office by the end of the 20th day of the successive month of each quarterly period.

Under the new changes, the rate of ACT is reduced to 20% and the payment will no longer be made quarterly, but semi-annually. Considering the fact that Turkey is a chronically high inflationary country (i.e., more than 80% yearly), the changes will have a positive impact on the tax burden of companies as the tax collection period (the available period with respect to the deferral/devaluation of the Corporate Income Tax (CIT) burden as a result of inflation) will effectively increase from 2 months to 5 months.

Tax-Free Asset/Stock Sales

The former "temporary section 23(a) exemption" in the Corporate Income Tax Act (CITA) provided that capital gains realized on the sale of a participation or of real estate, or the contribution of a business unit that constitutes part of the business assets of a corporation should, in principle, not be subject to CIT, VAT, and transfer taxes, provided:

- the proceeds from the sale/contribution are capitalized and are not distributed for a period of five years;
- the assets sold/contributed have been held by the vendor company for at least two years; and
- the sale/contribution and the capitalization of the proceeds is made before January 1, 1999.

If the proceeds are distributed by the vendor company to its shareholders in any form (including a deemed distribution) within five years from the date of capitalization, the capital gain is fully taxable in the year in which the gain is capitalized. The same rule is applicable if the company is liquidated, because a liquidation is also considered a deemed distribution. Upon the sale, a withholding tax will be due on the sale proceeds, but tax losses can be used to reduce the capital gain realized on the sale for the calculation of the withholding tax, if the vendor company has sufficient tax losses.

Under new changes, the exemption is extended (though under temporary section 28) until December 31, 2002. Accordingly, if the first two of the above conditions are met and the sale/contribution and the capitalization of the proceeds are made before December 31, 2002, the vendor company is allowed to use the exemption.

The provision relating to the rate of income tax withholding (formerly 11 percent) was not extended under the new tax changes. Instead, sales proceeds will be subject to income tax withholding at the corporate level. The Council of Ministers has not announced the income tax withholding rate, but it is expected to be in the range of 11 to 15 percent.

Nevertheless, the withholding will not apply if a Turkish company exchanges its assets for shares in a newly incorporated Turkish company, within certain limitations. Should this be the case, the transfer can be realized tax-free. Even though the transfer was not taxed, the transferee company takes a fair market value basis in the transferred assets and, therefore, can depreciate the assets anew. Under such a transaction, the withholding tax will also not apply.

In order to qualify, the minimum capital of the new Turkish company cannot be less than US$5,000,000, and if a foreign investor participates in the new company the minimum capital contribution of the foreign shareholder cannot be less than US$1,000,000. Further, following the transfer, the transferring company cannot be liquidated for a period of five years. To qualify for the new regime, the assets transferred must comprise one or more branches of activity provided that these assets are part of production activities. A branch of activity may be defined as both all the assets and related plant and machinery of a division which is regarded as an independent business from an organizational point of view, i.e., an autonomous business capable of functioning on its own, as well as an integral part of the overall production facilities. Transfers of real estate, e.g., the land on which the production plant is situated, also qualifies for the new regime.

Individual Income Tax Rate Changes

As of January 1, 1999, the lowest tax bracket for individual income tax purposes was reduced to 15% from the prior 25%. In this respect, the rates of individual income taxes are as follows:

Taxable Income (million TL)	Tax on the lower amount (million TL)	Rate on excess (%)
0 - 2,000	-	15
2,000 - 5,000	300	20
5,000 - 10,000	900	25
10,000 - 25,000	2,150	30
25,000 - 50,000	6,650	35
50,000 - over	15,400	40

Under the recent changes, the income tax rates will be increased 5% between 1999-2002 for all income taxpayers, with the exception of employment income withheld at source by the employee. Therefore, during this period, there will be a 5% difference in every tax bracket between the income tax rate of -- for instance -- a sole trader and an employee as the remuneration of an employee will be subject to a lower rate of income tax.

Individual Income Tax Return Requirements

Until 2002, individual taxpayers are not required to file a tax return with respect to: (i) income realized from repo transactions (i.e., sale of debt-securities with the requirement to purchase), (ii) interest income arising from term-deposit bank accounts and (iii) dividend income received from mutual investment trusts. Even if the individual taxpayer is otherwise required to file a tax return, the above mentioned types of income will not be reported on this return.

Further, if an individual realizes capital gain as a result of a sale of stock in a company, that person will not be subject to individual income tax, provided the holding period between purchase and sale is longer than three months. This facility will also be available until 2002 and will not apply to participation papers/shares issued by mutual investment funds.

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