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Turkey issues guidance on financing expense deduction restriction, taxation of share buybacks and reduced income tax rate for publicly held companies

On 25 May 2021, Communique No.18 (the Communiqué) regarding Amendments to the General Communiqué No.1 of the Corporation Tax Code was published in the Official Gazette. The Communiqué contains explanations on implementation of the restriction on the financing expense deduction, taxation of share buyback disposals, reduced corporate income tax (CIT) rate to be applied for corporations traded for the first time on Borsa Istanbul A.S (Borsa Istanbul), and the revised CIT rate to be applied in fiscal years 2021 and 2022.

Restriction on the deduction of financing expenses

The financing expense restriction rate was previously set at 10% of the total of expenses and costs incurred (such as interest, commissions, late charges, dividends, exchange rate differences, etc.) related to external liabilities used in the company excluding those added to the cost of investment. This restriction applies to companies whose current external liabilities exceeded their equities, to be applied exclusively to the excess portion. See EY Global Tax Alert, *Turkey amends tax laws on deduction of financial expenses and withholding rates on multi-year construction works*, dated 4 February 2021.

The Communiqué contains explanations on the implementation of the said restriction.

External liabilities are stipulated in the Communiqué as the total of the short-term and long-term liabilities in the balance sheet.

According to the Communiqué, corporations are to determine whether they are within the scope of the financing expense deduction restriction by comparing their external liabilities and equities based on their balance sheets, prepared in line with the Tax Procedural Code, as of the last day of the quarterly advance taxation periods.

The first application of the restriction will begin by the first quarter of the advance taxation period.

Taxpayers using the calendar year as its taxation period will take into account the balance sheet dated 31 December and taxpayers with a special taxation period will take into account the balance sheet prepared on the last day of the taxation period.

The restriction will be applied to financing expenses finalized by nature and amount as of 1 January 2021 in relation to the financing provided as of 1 January 2013. On the other hand, financing expenses that have been taken into consideration in the calculation of the corporation's tax base for the fiscal year 2020 and previous years shall not be subject to the financing expense restriction.

Furthermore, netting of financing revenues and expenses is not allowed in calculating the non-deductible expenses. Accordingly, the total financing expenses in relation to external liabilities will be taken into account for the financing expense deduction restriction.

Financing expenses that are already regarded as non-deductible expenses within the scope of other rules (i.e., thin capitalization, transfer pricing, etc.) will not be included in calculating the non-deductible financing expenses.

Taxation of share buybacks

Previously, a 15% withholding tax (WHT) had been imposed on the disposal of share buybacks of Turkish full tax liable corporations. See EY Global Tax Alert, *Turkey enacts law on restructuring certain receivables and amends certain tax laws*, dated 23 November 2020.

The Communiqué introduces explanations and provides some examples on the implementation of such taxation.

According to the Communiqué:

- Negative amounts resulting from the redemption of the repurchased shares by way of a capital decrease will be considered dividend distributions and subject to a 15% WHT on the date that the respective capital decrease is registered at the trade registry.

- Capital losses resulting from the sale of repurchased shares will be deemed as dividend distributions at the date of sale and will be subject to a 15% WHT. On the other hand, the Communiqué states that capital gains resulting from such transactions will not be made subject to WHT as described.

- If repurchased shares are not redeemed by way of a capital decrease or sale within two years of their acquisition, a 15% WHT will be levied on the difference between the acquisition value and the value of the repurchased shares on the last day of the two-year period.

Reduced CIT rate to be applied for corporations traded for the first time on Borsa Istanbul

The CIT rate was previously reduced by two points for corporations offered to the public at a rate of at least 20% to be traded for the first time on the Borsa Istanbul. The reduced CIT rate was to be applied for five accounting periods following the accounting period in which the public offering first occurred. See EY Global Tax Alert, *Turkey enacts law on restructuring certain receivables and amends certain tax laws*, dated 23 November 2020.

This implementation is not valid for banks, financial leasing, factoring and financing companies, payment institutions, foreign exchange institutions, asset management companies, capital market institutions, reassurance companies and pension companies.

According to the Communiqué, the 20% rate for public offerings shall be protected for five accounting periods in which the reduced CIT rate is applied. If the public offering rate is not protected or the corporation in question is dissolved within five accounting periods, the CIT tax which has not been accrued due to the above-mentioned provision shall be collected together with default interest.

Revised CIT rate to be applied in 2021 and 2022

The CIT rate in Turkey was increased to 25% for the fiscal year 2021, and to 23% for the fiscal year 2022. See EY Global Tax Alert, *Turkey increases corporation tax rate for 2021 and 2022 tax years*, dated 26 April 2021.

According to the Communiqué, the CIT rate of 25% for the fiscal year 2021 will be applied on annual/advance corporation tax returns to be declared as of 1 July 2021 to the income generated as of 1 January 2021.

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