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Doing Business in

Turkey

March 2008

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Introduction

This guide is written for companies interested in doing business in Turkey. It outlines key facts and figures on Turkey's economy, business infrastructure, laws and taxation. Sources quoted include Arti Değer's summary document and the CIA World Fact book. The information contained herein should be used for guidance only and is current as at March 2008. Every effort has been made to ensure that the facts contained in this publication are correct at the time of publication; however, no responsibility for loss resulting from action taken based on any material herein can be accepted. It is recommended that readers obtain further information and professional advice prior to making any decision.

About JHI

With offices in the Americas, Asia-Pacific and Europe, JHI is a leading international association for independent business advisors, financial consulting and accountancy firms. JHI exists to support the development of its member firms by facilitating communication, exchange, networking and resource sharing worldwide. Its members benefit from global networking while maintaining total practice independence. Admissions are subject to a rigorous selection process based on criteria including the quality of practice, reputation and geographical location.

JHI is one of the largest associations of its kind, with some 120 member firms in over 50 countries worldwide. Its members offer a broad range of accounting, auditing and management consultancy services, and develop their business capacity through the association's global network. JHI's worldwide coverage enables its members to access support and cost effective business solutions, no matter where in the world their business takes them. JHI members benefit from a diverse programme of regional and international conferences, designed to engage, facilitate professional development, challenge and stimulate member firms, whilst offering unparalleled opportunities for networking and business development. JHI is also a leader in providing value-adding services to members, including Special Interest Groups addressing the latest market trends on information technology, tax and auditing, financial services, practice management, forensic accounting and litigation support, as well as topic-specific discussion forums addressing the professional needs of managing partners and doing business in different countries.

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Key facts

Population: 70 million

Currency: Turkish Lira (TRY)

Time zone: GMT +2

Dialling code: +90

Language: Turkish

Fiscal year: 1 January - 31 December

Business hours:

0900 - 1800 Monday to Friday. Public holidays are: 1 January, 23 April, 19 May, 30 August, 30 September-2 October, 29 October, 8-11 December.

Political context

Turkey is located at the intersection of old continents, namely Asia, Europe and Africa. Straddling the point where Europe and Asia meet, 97% of the country is located in Asia (the Anatolian Plateau) and 3% in Europe (Eastern Thrace). It is of no surprise that history shows the country's location is the birthplace of many great civilisations, as these lands have been the centre for culture and commerce because of its unique location towards three continents and the sea surrounding it on three sides.

The country occupies an area of 814,578 square kilometres, approximately equivalent to the combined areas of Germany and France, and larger than the state of Texas. The continents of Europe and Asia are separated by the Bosphorus Strait, Marmara Sea, and the Dardanelles Strait, all within the borders of the Turkish territory. The Anatolian Plateau is bordered by the Black Sea to the north, the Aegean Sea and the Marmara Sea

to the West, and the Mediterranean Sea to the south. Turkey has a coastline of 8,000 kilometres and a land border of 2,573 kilometres. The country is neighbour to European and Asian countries: Greece, Bulgaria, Georgia, Azerbaijan, Armenia, Iran, Iraq and Syria. Ankara, the capital city, is situated in Turkey's heartland at the center of the Anatolian Plain, which is a high plateau region raising steadily to the east.

The parliamentary democracy has a single chamber, the Grand National Assembly, and a President. The assembly is composed of 550 members elected for a five-year term. Elections are held every five years unless the government decides to call for an early election. Citizens at the age of 18 or older have the voting right. In general application, the votes are cast for political parties, however individual candidates have the legal ground to be elected as a member to the Assembly.

Economy

The value of the TRY against the major foreign currencies is fluctuating depending upon the stability of the economy. As of December 31, 2007, USD 1 was equal to TRY 1,1593.

The Turkish economy has changed significantly during the last decades. Reforms starting in 1980 have adopted free market economy principles and in this context, emphasised international trade, encouraged foreign capital investments and liberalised exchange controls.

A standby agreement between the IMF and the Turkish Government was signed in December 1999. In parallel, the government announced a new economic and monetary programme to decrease inflation and devaluation, put public financing onto a sustainable path, decrease real interest rates and restore sustainable growth. Exchange rate targets were precisely met; however, continuous overvaluation in the Turkish Lira led to a rise in imports and put pressure on the current account balance. The monetary programme collapsed in

February 2001 and the crawling peg exchange regime had to be replaced by a floating exchange rate system. Nevertheless, Turkey continued to implement IMF-prescribed policies under the floating exchange rate system, including tight fiscal policy targeting a primary budget surplus of 6.5%, comprehensive banking sector restructuring and implicit inflation targeting.

A steady economic growth has been followed by a significant change in the composition of the GNP, evidenced by the decreasing share of the agricultural 6 sector in Turkey's GNP, and the share of the industry and particularly services marking an important increase. Turkey's recorded GNP grew in real terms in 2002 and 2006, as shown below.

Having faced serious economic problems in the recent years, Turkish economy resumed its growth trend in 1999 and 2006.

Legal and judicial system

Turkey is a republic in which power is divided between the legislatures, the executive and the judiciary. Under the 1982 constitution the Turkish parliament (TBMM) is the sole legislative body, exercising supreme power.

Executive power is exercised by the President and the Council of Ministers, in accordance with the constitution and the law. The Judiciary operates independently on behalf of the state.

Turkish Parliament (TBMM)

The parliament (TBMM) consists of 550 deputies who are directly elected by universal adult suffrage. Elections take place every five years or less at the discretion of the government. The Council of Ministers (the cabinet) is headed by the Prime Minister and is responsible to

Parliament. After an election the President invites the leader of the largest party to form a government. If successful, he or she is then appointed Prime Minister and nominates ministers who are in turn approved by the President.



Foreign investment

General explanations about Foreign Investment in Turkey and Procedures to be fulfilled used to be mainly regulated within the Law numbered 6224 on Encouragement of Foreign Capital, which was enacted on January 18, 1954. This law was quite liberal in comparison to the legislations of most of the other OECD countries of those times. The term "encouragement" in the name of the Law 6224 derived from the presence of some principles that were intended as real incentives, such as "free transfer" and "national treatment". However, notions, definitions and applications concerning foreign direct investments have changed so rapidly that the Law 6224 lagged behind the contemporary demands of both foreign investors and Turkey. As a result the need for a new Foreign Direct Investment Law emerged. Therefore a new Law concerning Foreign Investment in Turkey was enacted with Law numbered 4875. This new Law came into force on the 17th of June, 2003 and mainly it emphasises the key elements of the liberal investment environment in Turkey.

The new Law is an integral part of a broader national reform programme that is laying the foundation for sustainable growth and development, driven by private investments in a transparent marketplace fully open to the world and supported by a smaller but more effective State. To ensure that Turkey's bold fiscal adjustment and ambitious structural reforms translate into substantial investments, the Government of Turkey is focusing on improving the investment climate as one of the main pillars of its economic programme. In addition to the introduction of a more investor-friendly new Law, the Government of Turkey has established by a decree an inter-governmental Coordination Committee for the Improvement of the Investment Climate (YOIKK),

composed of high-level representatives of relevant ministries, the private sector and Non Governmental Organisations to help remove remaining bureaucratic obstacles to investment in Turkey. The Government of Turkey also intends to set up a well-funded new Investment Promotion Agency that will simultaneously work inside the government and draw private sector knowledge and market skills, to carry out a multi-year strategy to promote investment in Turkey.

The objective and scope of the Law is defined as to encourage foreign direct investments; to protect the rights of foreign investors; to define investment and investor in line with international standards; to establish a notification-based system for foreign direct investments rather than screening and approval; and thus regulate the principles to increase foreign direct investments through established policies.

Key features of the new Foreign Direct Investment Law include:

- Freedom to invest by dropping all former General Directorate Foreign Investment-related to screening, approval, share transfer and minimum capital requirements;
- Reassurance of existing guarantees to foreign investors of their rights in one transparent and stable document;
- Upgrading to accepted international standards for definitions of 'foreign investor' (broadened to include Turkish national residents abroad and international organisations) and 'foreign direct investment' (broadened to include all possible types of assets);

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and

- A policy shift from ex-ante control to a promotion and facilitation approach, with minimal ex-post monitoring to continuously improve an investor-friendly climate for growth and development.

Within the Foreign Direct Investment Law, regulations had been made in conformity with international standards. "Foreign direct investment" and "Foreign investor" terms are defined in accordance with international standards in order to clarify the field of application of the Foreign Direct Investment Law. Within this scope:

(a) **Foreign investor** is defined as follows:

- 1) *Real persons who possess foreign nationality and Turkish nationals resident abroad,*
- 2) *Foreign legal entities established under the laws of foreign countries and international institutions who make foreign, direct investment in Turkey.*

(b) **Foreign direct investment** is defined as follows:

- 1) *Establishing a new company or branch of a foreign company*
- 2) *Share acquisitions that are not by means of capital markets, and share acquisitions through capital markets where the foreign investor owns 10% or more of the shares or voting power, by means of but not limited to the following economical assets:*

i) *Assets acquired from abroad by the foreign investor:*

- *Capital in cash in the form of convertible currency bought and sold by the Central Bank of Turkey,*
- *Stocks and bonds of foreign companies (other than government bonds),*
- *Machinery and equipment,*
- *Industrial and intellectual property rights*

ii) *Assets procured from within Turkey:*

- *Reinvested earnings, revenues, financial claims, or any other investment-related rights of financial value*

Commercial rights are for the exploration and extraction of natural resources.

The most important issue covered in the Foreign Direct Investment Law is the rights of the foreign investors. The new Law guarantees national treatment and comprehensive investor rights. All companies established with foreign capital contribution and under the rules of the TCC (existing and newly established foreign companies) are regarded as Turkish companies. Therefore equal treatment both in rights and responsibilities as stated in the Constitution and other laws is applicable to all such companies (including freedom to invest, national treatment, a guarantee against expropriation without compensation, transfer of proceeds, access to real estate and to expatriate personnel, and international arbitration or any other means of dispute settlement).

The entry conditions for establishing a company in Turkey for foreign investors are the same as for comparable local Turkish companies. There is no minimum amount of capital required. (It is no longer obligatory to bring a minimum of \$50,000 in share capital by each shareholder).

There is also an article concerning liaison offices in Turkey, for such an establishment the under secretariat of Treasury is authorised to permit foreign companies established under the laws of foreign countries to open a liaison office, provided that they do not engage in any commercial activities in Turkey.



Taxation

From the point of view of a foreign investor, the most important Turkish taxes are as follows;

- **Corporation tax**
- **Individual income tax**
- **Value-added tax**
- **Bank and insurance transactions tax**
- **Stamp duty**
- **Special consumption tax**

Corporations are regarded as unlimited taxpayers if either their statutory head office or actual business centre is located in Turkey. Thus, fully foreign-owned subsidiaries established in Turkey under the Turkish

Commercial Code are regarded as unlimited taxpayers whereas foreign branches are treated as limited taxpayers.

With regards to individuals, the tax status is determined according to the criterion of "residency". Turkish citizens are accepted as resident, unless they have evidence of residence abroad. Foreigners are regarded as resident if they stay in Turkey without interruption for more than six months in a calendar year other than for reasons of imprisonment, illness or assignment or specific and temporary projects.

Partnerships (Joint venture and consortia) are not taken into consideration in determining tax status. The partners' residence status is taken into account for tax treatment.

Corporate Tax

Enacted in June 2006, Corporate Tax Law (No. 5520) replacing the former corporate tax law dated 3 June 1949 (No. 5422). The new Law, applicable from 1 January 2006, reduces the corporate tax rate from 30% to 20% while

re-regulating the earnings exempt from tax and the reduction.

Tax Liability

Resident companies are liable for corporation tax on their worldwide income, while non-resident companies are taxable for only the income earned in Turkey.

Whether or not a company is subject to full tax liability depends on its status of residence. A company that has a statutory domicile or a place of management will have

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full tax liability. This means the company is obliged to keep accounting books, and file periodical tax returns. If there's no presence in Turkey, in most cases, instead of annual declaration, "withholding method" is used for charging Turkish tax. Therefore, the capital companies, such as "A.S." and "Ltd.", established in Turkey have full tax liability.

If a non-resident company carries out business through a branch or a joint venture, then it will have a limited tax liability; i.e. fully subject to corporate tax on profits earned in Turkey. It should be noted that corporate tax of foreign entities that have limited tax liability is imposed on the name of their manager or representatives in Turkey. In case such a person does not exist, the tax is imposed on the persons who provide such income to the foreigners.

Exemptions

The following earnings of corporations are exempted from corporate tax;

- Dividend income from other Turkish companies,
- Dividend income received from foreign subsidiaries or branches when certain conditions are fulfilled,
- Capital gains of holding companies from foreign subsidiaries with certain conditions,
- Earnings of the following funds and companies that are established in Turkey:
 - Portfolio management earnings of investment funds/companies,
 - Real estate investment funds/companies,
 - Venture capital funds/companies,
 - Pension funds,
 - Housing financing funds and assets financing funds

The rate of corporation tax is 20%.

Furthermore there is a corporate withholding tax at the rate of 15% if the company distributes dividends.

Taxpayers also have to prepare a balance sheet and income statement for threemonth periods and pay 20% as an advance tax. Quarterly advance corporation tax returns must be submitted to the tax office by the 10th day of the second month following the end of the quarter. Due date for the payment is the 17th day of the month in which the tax return is submitted.

- With certain conditions, 75% of the capital gains from disposal of subscription shares and immovable properties that are held for over two years.

Ministry of Finance is authorised to determine the basis of principles for the exemptions above.

Deductions

In principle, an expense is deductible if it is related to the generation of income or the operation of a business. The following items are allowed as deductions for both the corporate and income tax purposes;

- Travel and lodging expenses adequate to the size of business,
- Meals provided to the employees on site,
- Social security contributions,
- Compensation and losses incurred according to a contract or a court decision,
- Expenses of leased or owned vehicles that are used for business purposes,
- Real estate and transfer fees, stamp duties and municipal taxes, which are related to the business,
- Depreciation expenses calculated by the methods of the Tax Procedural law,
- Employer's contributions to the labour unions and to the private pension plan of the employees (there are upper limits),
- Cost value of food stuff donations to the food banks,
- Donations to certain institutions and associations for charitable works (up to a limit).

- Bad debt provisions, if legal action towards enforcing the payment has been taken,
- Interest paid for business purposes in an operational period may be deducted; however the interest must be capitalised if it relates to the acquisition of a fixed asset.

In addition to the above, corporate taxpayers are allowed to deduct the following;

- Costs of the issuance of corporate securities,
- Start-up costs,
- Expenses incurred for general assembly meetings,
- Cost of merger, demerger and liquidation transactions,
- Technical reserves for insurance and reinsurance companies,
- Business losses inherited from a merger/demerger transaction (subject to a limit),
- Losses incurred in foreign jurisdictions (subject to certain conditions).

Disallowable Expenses

- Interest paid or calculated on the basis of equity capital,
- Interests and foreign exchange losses on disguised capital,
- Disguised profit distribution through transfer pricing,
- Legal reserves and other profit reserves,
- Penalties and indemnities resulting from delinquencies of the taxpayers and/or his employees,
- Corporate tax, income tax and delay charges calculated in accordance with the Public Receivable Collection Law,
- Motor vehicle tax of the vehicles except for those used in the business for commercial purposes. The tax-loss is carried forward and set off against the income of subsequent years for five years. For carrying forward, the loss corresponding to each year must be specified in the corporate tax return. There are no loss carry-backs.

Individual Income Tax

Tax Liability

Individuals residing in Turkey are liable for income tax on their worldwide income, but non-resident individuals are liable for income tax only on income earned in Turkey.

Residents may deduct from their income tax liability foreign taxes assessed on foreign income. However, such deductions may not exceed the rate of tax assessed for similar income earned in Turkey.

Tax is charged on the net income derived from the following seven sources.

- Income from commercial and business activities,
- Income from agriculture,
- Income from independent professional services,
- Wages and salaries,
- Income from immovable assets and rights (including rents),
- Income from capital investments (including dividends and interest),
- Other income (including capital gains and occasional earnings).

Individuals who deal regularly with trade or business or agriculture, or independent professional services, have to fulfil all tax responsibilities stated in the procedural law. They are held responsible for keeping books, filing annual and monthly tax returns, consolidating the profits and earnings from various sources of income, etc.

On the other hand, an individual whose income consists only of a wage is not obliged to file a tax return. This is also applicable to the some extent for an individual that earns only one type of income. Although withholding is the major taxation method for the most of passive incomes such as dividends, interests, rents, individuals whose income exceeds certain threshold must file annual income tax declarations. Therefore, one should seek advice from a tax adviser whether s/he has to file an annual return or not.

Tax Rates

The rate of individual tax is between 15% and 35% depending on the amount earned during the fiscal year. The tax tariff for 2007 earnings is shown below. (TRY)

Lower Bracket	Upper Bracket	The tax on Lower	Tax Rate %
-	7.500	-	15
7.500	19.000	1.125	20
19.000	43.000	3.425	27
43.000	-	9.905	35



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Value Added Tax (VAT)

Value added tax is levied on all goods and services supplied within the scope of commercial, industrial, agricultural and independent professional activities and on the import of goods and services.

Persons who deliver the goods or perform the services are liable for VAT. Imported goods are taxed at the point

of entry and the tax is collected by the Customs authorities from their importer.

Foreign-owned businesses (both subsidiaries and branches) operating in Turkey are treated as regular taxpayers.



Additional Information

Foreign exchange controls

Turkey does not impose foreign exchange controls.

Debt-to-equity ratios

There is a 30% rule in Turkey concerning the ratio between a company's debt and equity.

Anti-avoidance legislation

A Turkish company or taxable legal entity cannot change domicile to another country. This will normally be considered liquidation with the same tax effect as a sale. However, the company can move its activities abroad, but, to prevent tax avoidance, such a transfer is considered disposal.

If a foreign subsidiary of a Turkish company is in fact without actual substance and activity (a 'shell company'), the Turkish tax authorities may consider the foreign company a nullity and add the subsidiary's income to the income of the Turkish parent.

Incentives

Incentives are equally available for both domestic and foreign investors. The incentives available for investors are presented below.

Tax Incentive on R&D Expenditures

Both corporate and individual income taxpayers are allowed 40% of their enterprises' research and development expenditures to deduct from their taxable

income on their annual tax returns. The amount must be spent solely for searching for a new technology and information.

Free-Trade Zones

The areas within the free zone boundaries are treated as extraterritorial for customs duties purposes.

The zones were primarily designed to encourage trade to and from Turkey and to encourage foreign investment which is not primarily directed at the Turkish market. However, with the arrangements made in 2004, under the current situation, the Free Zones are expected especially to perform activities related to production. Although the permits that have been granted to companies already existing in the free zones are still valid, companies that are willing to operate in free zones are obliged from now on to make production investments. Taxpayers who obtained a permit for operation in free zones before 6 February 2004 benefit from the following tax incentives;

- Operating profits arising from their activities within these zones are exempt from income or corporation tax for a limited period, as indicated in their permits.

- Wages/salaries paid to personnel employed in these zones are exempt from income tax until 31 December 2008.
- Transactions carried out in connection with their operations in these zones are exempt from taxes, duties and charges until 31 December 2008.

For taxpayers who started their operations in free zones after 6 February 2004; profits arising from the export of products manufactured in these zones are exempt from income or corporation tax until the end of the taxation period that would include the date when full membership to the EU is achieved. Validity of the exemptions shall end if the operation permit expires before the EU accession.

Techno Parks

Technology development zones (Techno parks) have been founded in order to produce technological information to make innovations in products and production techniques, to support technology intense productions, to support entrepreneurship and to provide technological basis that will enhance foreign investment flow to Turkey.

The number of techno parks that have been organised like Free Zones under the Technology Development Zones Law (No.4691) is expected to increase in the future.

Tax and similar advantages in the zones area as follows:

- Income and corporate tax payers operating in techno parks are tax exempt from income derived from R & D and Software production until 31 December 2013.
- The salaries of personnel are tax exempted until 31 December 2013.
- Software sales are VAT exempted.

Managing companies incorporated as joint stock companies to undertake management and operation of these areas are exempt from all taxes, duties charges in transactions related to the implementation of the Law

Incentives Rising Investment and Employment

The Law number 5084 and its amendment No.5350 are intended to increase investment and employment opportunities in the priority regions and the less industrialised regions. These provinces are those with a gross domestic product per capita equal to or less than US\$ 1,500. Currently, 49 provinces out of a total of 81 are covered by the regulation.

Under the Law, available incentives are as follows:

- **Income tax exemption support:** Income and corporate taxpayers who started a new operation in those areas, by recruiting a minimum of 30 employees, and also the taxpayers who decide to increase the number of employees by 20% to reach a minimum of 30, shall be granted an income tax exemption of 100%. This will apply to Organised Industrial Zones and Industry Zones. There will be an income tax exemption of 80% for enterprises in other zones.
- **Support for the employers' share in social insurance premiums:** In a case where the above recruitment conditions are met, 100% of the Employers' Share of the total Social Insurance Premiums is paid by the Treasury. This will apply to Organised Industrial Zones and Industry Zones. The Treasury will pay 80% of the total Social Security Premiums for enterprises in other zones.

■ **Assignment of free land for investment:** Real and legal entities, who are engaged in investments and who anticipate a minimum of 30 employees, may be assigned lands of the Treasury free of charge.

■ **Energy support:** The Treasury will subsidise 20% of the electricity expenses of the enterprises and this will apply until 31 December 2008 in the following fields:

- Manufacturing, mining, tourist accommodation, education, and health facilities
- Stock farming, greenhouse cultivation, certified seed propagation, cold storage facilities.

General Investment Encouragement Programme

Decree No. 2006110921 Concerning Government Subsidies for Investments has recently introduced this programme. The purpose of the programme is to encourage, support and orient investments, in conformity with the objectives of Development Plans and Annual Programmes. The investment feasibility studies and proposals submitted to the Under Secretariat of Treasury may be granted an investment encouragement certificate by the authority. With a granted certificate, the

eligible projects can benefit from the following encouragement measures:

- Exemption from customs duties and fund levies
- V.A.T. exemption for imported and domestically purchased machinery and equipment
- Interest support for investment loans to be used in certain sectors and regions



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State Aid Granted to SMEs' Investments

According to the SME (Small and Medium Sized Enterprise) definition within the framework of the relevant Decree, the investments of SMEs can benefit from similar encouragement elements expressed in the

paragraph above. Please note that there are restrictions by sectors, and certain ceilings set in respect to the total investment amount, the amount of credits to be allocated, and so on.