



MERGERS AND ACQUISITIONS

# Turkey

Taxation of Cross-Border  
Mergers and Acquisitions

2010 Edition

TAX

# Turkey

## Introduction

The Turkish tax environment for mergers and acquisitions (M&A) has been affected by a number of inflexible or uncertain tax issues that have yet to be resolved. Nevertheless, as a response to the global financial crisis, Turkish Government has introduced a number of incentive measures, including tax incentives that may potentially be applicable in cross-border M&A.

This chapter begins by explaining recent tax developments that could potentially be of importance when planning a cross-border merger or acquisition and goes on to discuss the key issues when developing a tax-efficient transaction structure.

Two kinds of capital company are typically used in Turkey for cross-border M&A; a joint stock corporation (Anonim Şirket [A.S.]) and limited liability company (Limited Şirket [Ltd.]). Our discussions below relate to A.S. or Ltd. unless otherwise stated.

## Recent Developments

### Additional Tax Incentives for SME Mergers

A tax-free merger structure has already been introduced in the Turkish Corporate Tax Law. Basically, such a merger can be achieved between two Turkish-resident companies provided the it is conducted on the basis of book values and other procedural obligations (such as filing) are satisfied.

Now, following the addition of the Provisional Article 5 to the Turkish Corporate Tax Law, there is another way to structure a tax-free merger between small and medium size enterprises (SMEs) until the end of 2009. The main criteria to qualify as an SME are:

- the number of employees was between 10 and 250 in the last social security declaration of year 2008; and
- annual net sales or total assets were below TRY 25 million for year 2008.

The main advantages associated with this Article are:

- The merger itself is not subject to any tax (corporate tax, VAT and stamp tax) not applicable

under the existing tax-free merger provisions in the Turkish Corporate Tax Code.

- The assets will be transferred on the basis of market values during the merger, which allows a step-up of the asset base that will be exempt from corporate tax (as opposed to a usual tax-free merger, where the assets have to be transferred on the basis of book values with no step-up).
- The merged entity will be entitled to a reduced corporate tax rate for a period of three years following the merger (including the year in which the merger took place). Effectively, this implies years 2009, 2010, and 2011.
- The Council of Ministers has been vested with the authority to decree reductions of corporate tax rate by up to 75 percent of the original rate (20 percent) and has used this authority with the Decree 2009/15386, dated on 5 August 2009, which has reduced corporate income tax rate from 20 percent to:
  - 5 percent on the income of the merged entity at the time of the merger; and
  - 5 percent on the income of the merging entity for a period of three years following the merger (including the year in which the merger took place).

But taxpayers should note that the Article includes an anti-abuse clause that stipulates that a merger designed mainly for the purpose of benefiting from the tax incentives can be denied the tax incentives by the tax authorities.

### Asset Peace Act

As a part of the fiscal stimulus response to the global financial crisis, Turkey introduced a new Law No: 5811 (also referred to as the Asset Peace Act) on 22 November 2008, which legalized certain unrecorded assets and encouraged their injection into Turkish economy.

The application date of this law (which originally expired on 2 March 2009) was extended to 31 December 2009.

The assets that can be declared under the Asset Peace Act include cash, foreign currency, gold, securities, other capital market instruments, and real estate in the possession of the tax payer as of 1 June 2009.

Following such a declaration:

- The taxpayers had to pay a onetime tax on the value of the assets declared, which was 2 percent of assets brought from abroad and 5 percent of the assets in Turkey.
- Turkish individuals and companies who declare their unrecorded assets either in or out of Turkey will not be further subject to inspection on their source and at the same time the tax payer received a relief against future assessments by the tax authorities up to the amount of the value of assets declared. Hence, in practice the Asset Peace Act could be used as a partial tax amnesty against potential historical tax exposures for the period before 1 January 2008.
- The Asset Peace Act also provides specific exemption for certain participation gains, branch profit, capital gains, and liquidation proceeds repatriated to Turkey until 28 February 2010.

The Asset Peace Act is thus a tool to tackle potential historical tax liabilities of a target company in an M&A transaction.

But the following risks have been noted as barriers to the successful use of the Asset Peace Act:

- The law provides no shelter other than tax (such as anti-money laundry regulations, etc. should still be applicable), but it could still be advantageous unless the person has some other illegal operations.
- Nor does the law provide any relief against the tax audits that may be related to periods after 1 January 2008. This means a declaration under the Asset Peace Act may represent a disclosure to the Turkish tax authorities if such activities leading to undeclared gains continued after this date.
- The assets injected into the company can be either kept as reserve or added to the share capital; but they cannot be repatriated from the company until liquidation. Hence, such assets injected into a target before a potential deal will probably increase the purchase price, which may give rise to financing problems for the buyer (who will be unable to repatriate these assets post acquisition)

### ***Re-Determination of Withholding Taxes (WHT) on Interest Payments***

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In accordance with the Turkish Corporate Tax Law, and the related Decrees issued by the Council of Ministers, the interest payments from a Turkish entity to a non-resident entity were subject to WHT at 10 percent; which could be reduced to 0 percent if the foreign entity receiving the payment qualified as a bank or financial institution.

As a part of the fiscal stimulus measures responding to the global financial crisis, the following re-determination on interest rates was made:

- the application of 0 percent WHT on interest payments to foreign banks and financial institutions is continued (but excludes payments to intra-group financing companies, so called SPVs);
- reduced WHT of 5 percent is introduced for interest payments to foreign entities due to purchase of goods on credit;
- reduced WHT of 1 percent is introduced for interest payments of banks on credits received through securitization; and
- 10 percent WHT on interest payments other than the above mentioned are still applicable.

The above changes do not represent a major change for M&A structuring in Turkey, but they should be taken into account when determining the financing structure of an acquisition, or leakage from future cash flow that may be a key factor in the financial model underlying the investment plans.

### **Asset Purchase or Share Purchase**

A foreign company can acquire a Turkish company by acquiring either its assets, or its shares.

An asset acquisition can be effected either through a branch of the foreign entity, which is taxable in Turkey on a non-resident tax status, or through a Turkish subsidiary of the foreign company.

### ***Purchase of Assets***

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Goodwill (that is, a positive difference between the purchase price and the fair market value of assets acquired, if any) can be recognized and depreciated over five years.

Tangible and intangible assets can be amortized, based on the rates determined in accordance with the useful

life of the assets as announced by the Ministry of Finance.

Transfers between the related parties have to be at fair market value.

### *Purchase Price*

In principle, the transfer of assets under an asset-deal type transaction should be conducted at fair value, which should be the market value. Transfers between related parties must be documented to comply with transfer pricing requirements.

For the buyer to book the individual assets at their transfer value and determine the goodwill amount (if any), the purchase price has to be broken down and allocated to individual assets being transferred. It is generally advisable for the purchase agreement to specify the allocation, which will normally be acceptable for tax purposes provided it is commercially justifiable.

The allocation of purchase price is more important if there are any assets in the deal, the transfer of which may be exempt from corporate tax and/or VAT (such as real estate property or shares/participation rights in another entity).

### *Goodwill*

In case of an asset-deal, an excess of the purchase price over the fair value of the assets being transferred represent the goodwill, which can be capitalized by the buyer and depreciated for tax purposes over a period of five years.

Turkish tax law does not require recognition of internally developed goodwill and rights in the tax basis balance sheet, so there is usually no tax basis cost for the goodwill in the seller's books and it, therefore, represents pure taxable income.

### *Depreciation*

The depreciation period of assets are refreshed in an asset deal. The selling entity has the right to deduct all remaining net book value of assets as the tax basis cost against the transfer value; and the buyer has to book the assets at their transfer value and start depreciating a new term of useful life for each asset (as prescribed by the Communiqués of the Ministry of Finance).

### *Tax Attributes*

The tax attributes (that is, tax losses and incentives) are not transferred to a buyer in an asset deal. However, the selling entity has the right to use its existing tax

losses and VAT credits against the taxable profits (such as capital gains) and VAT obligations arising from the asset transfer.

One should also note that if the target has used an Investment Incentive Certificate (common in energy investments) then the transfer of assets for the first five years is both subject to the permission of the Turkish Treasury and may give rise to a denial of potential tax exemptions the seller is already entitled to under the Investment Certificate.

On the other hand, the potential tax liabilities of the seller should not be transferred to the buyer in an asset deal, except for a special case identified in the Law Regarding Collection of Public Receivables, which allows the tax office to put aside a transaction and pursue the assets if the deal is structured to avoid payment of the seller's tax liabilities of (which may only be possibility in the case of related-party transactions).

### *Value-Added Tax (VAT)*

Tax-free mergers (including tax-free SME mergers) and tax-free divisions (satisfying the conditions stipulated by the Corporate Tax Law) are exempt from VAT.

Taxable mergers and asset transactions (including goodwill) are generally subject to VAT at 18 percent, but there is an exemption for real estate property or shares/participation rights held by a company for at least two years and transferred through an asset deal.

The purchaser is entitled to recover the VAT so incurred against its output VAT generated from its operations, and, therefore, recovery of input VAT may impose a financial burden (time value of money), if the capacity to generate output VAT is limited after the acquisition.

Sales of shares in an AS company are exempt from VAT. A sale of shares in a Ltd. company by another company is exempted from VA, if the participation is held for at least two years. A sale of shares by an individual is not subject to VAT.

### *Transfer Taxes*

Certain documents prepared in Turkey (share purchase agreements, loan contracts, and mortgage instruments, among others) are subject to stamp duties, usually at 0.75 percent. Loan contracts (and security documents, such as a mortgage) with respect to a loan from a local or foreign bank are exempt from the stamp duty.

Merger agreements are also included in the scope of stamp duties. Nevertheless, documents related to tax-

free mergers or tax-free divisions (satisfying the conditions stipulated in the Corporate Tax Law) and documents related to the sale of real estate property or shares/participation rights held by a company at least two years are also exempt from stamp duty.

In an asset deal, a transfer of title to real estate is subject to a title deed registration fee of 1.5 percent for both seller and buyer separately. Registration of a mortgage is subject to a fee of 0.36 percent.

## **Purchase of Shares**

Acquisition of shares by a foreign entity has no immediate Turkish income tax consequences.

If the acquisition is through a Turkish branch or subsidiary, goodwill implicit in the share price cannot be recognized for tax amortization purposes. Nor is it possible to achieve a tax basis step-up for the target company assets.

A change in the shareholders will have no effect on the tax attributes of the target company.

### *Tax Indemnities and Warranties*

In a share deal transaction, the historical tax liabilities of the target (known or unknown) remain in the company and are acquired by the new shareholder(s). It is, therefore, usual for the buyer to ask for tax indemnities and warranties in a share acquisition.

The accounts of a company are open for tax audit for five years and there is no procedure to agree the tax status of a company with the tax authorities. In view of this, and due to insufficient coverage of tax audits in Turkey (that is, the tax authorities can only review a limited number of taxpayers and the tax litigation cases usually take long time for a final resolution), the indemnities and warranties are even more stringently applied in share acquisitions in Turkey.

### *Tax Losses*

Tax losses can be carried forward for five years. No carry-back is possible.

After the acquisition of shares, the target company can continue to carry forward its tax losses without any further specific requirements stemming from the share transfer.

Tax losses of the merged entity can be used by the merging entity if tax-free merger conditions are met.

### *Crystallization of Tax Charges*

Since the transfer of shares in a company has no effect on the tax status of the assets, this issue is not applicable for Turkey.

### *Pre-Sale Dividend*

If the target entity has retained profits available for distribution as dividends, the potential tax implications of a pre-sale dividend as against a capital gain should be considered in the light of the circumstances buyer and seller.

### *Transfer Taxes*

Agreements relating to purchases and sales of shares are normally subject to stamp duty at 0.75 percent.

Agreements relating to transfers of shares of Turkish companies by other companies after a holding period of two years are exempt from stamp duties by virtue of the specific exemption provided by the Corporate Tax Law.

### *Tax Clearances*

It is not possible to ask for tax clearances from the Turkish tax authorities regarding the tax status of a company.

It is only possible to ask for an official statement from the tax office outlining the reported, but unpaid tax liabilities of the company or confirming that there are no overdue and unpaid tax obligations. However, such statements do not provide any assurance against the contingent tax liabilities that may be identified in the course of a tax audit.

It is also possible to ask for advance tax rulings for specific structural tax uncertainties in a merger or acquisition.

## **Choice of Acquisition Vehicle**

The following section discusses the acquisition vehicles that may be used in structuring a merger or acquisition in Turkey.

In all cases, there is no capital duty or stamp duty on injection of equity into a Turkish company or branch, but the equity contribution is subject to a fund (that is, contribution to the Competition Board) of 0.04 percent (four per 10,000)

### **Local Holding Company**

The form of a Turkey holding company is usually A.S. or Ltd. company, or a specific holding company (as defined

in the Turkish Commercial Code, which is a special type of an A.S. formed with the primary purpose of investing in other companies). There is no material taxation difference between these forms, but it should be noted that the special holding company is advantageous, because it has a higher dividend capacity than other forms.

Turkish corporate tax law also specifies a special holding company regime and related tax incentives for the purpose of holding the shares or foreign investments through a holding company in Turkey.

A Turkey holding company is not usually seen as an efficient alternative, because of the absence a tax grouping regime in Turkey, which means the acquisition costs and interest expenses at the level of holding company cannot be offset against the target's profits. Although it is theoretically possible to achieve a deductibility of acquisition costs and interest expenses through a post-acquisition merger of the holding company into the target, such structures are under scrutiny by the Turkish tax authorities and have been challenged through the substance-over-form principle. Such structures should, therefore, be analyzed carefully and professional advice should be sought on a case-by-case basis.

A Turkey holding company may be a tax-efficient option if the acquisition in Turkey is financed with equity, rather than debt, and the foreign investor intends to re-invest in Turkey. In this case, the Turkey holding company can receive dividends from the target entity without any tax leakages (that is, participation exemption rules), and may use the dividends received for re-investment in other Turkish businesses.

### **Foreign Parent Company**

The foreign purchaser may choose to make the acquisition itself, perhaps to shelter its own taxable profits with the financing costs. This will not cause any direct taxation problems in Turkey. However, Turkey charges WHT on interest and dividend payments to a foreign party; so, if relevant, an intermediate company resident in a more favorable treaty territory may be preferred.

### **Non-Resident Intermediate Holding Company**

To ensure a more tax-efficient flow of payments from the Turkish entity to its foreign parent, and to eliminate potential capital gains tax that may be applied on a subsequent exit, an intermediate holding company resident in another territory could be used. While determining the applicability of treaty benefits, Turkish

tax authorities usually rely on a tax-residency certificate issued by the tax authorities of the territory where the intermediary holding is located. So the substance tests, if any, should be done from the perspective of the tax laws of the territory where the intermediary holding is to be located.

### **Local Branch**

It is possible for a foreign company to hold the shares of a Turkish target through a branch established in Turkey. In general, the branch (though regarded as a non-resident for tax purposes) is subject to tax rules similar to those applying to other company forms in terms of its Turkey income and transactions.

However, in practice a branch is not seen as a favorable option because of the following:

- dividends paid from a Turkish target to the branch are not entitled to participation exemption;
- the remittance of profits as well as dividends from the branch to its foreign parent are subject to WHT; and
- it is an inflexible structure, because the branch cannot be legally transferred to a third party in a subsequent exit.

### **Joint Ventures**

A joint venture can be established in between a Turkish company and one or more local or foreign entities. If such a joint venture company is incorporated, it takes an ordinary legal form as discussed above (that is, A.S. or Ltd.) and is thus subject to same tax implications. An incorporated joint venture may be registered for tax purposes but it can only be used for specific contractual works and is not available as a holding company structure.

### **Choice of Acquisition Funding**

A purchaser structuring an acquisition in Turkey will need to consider whether to fund the vehicle with debt or equity. Hybrid financing instruments are not recognized for tax purposes in Turkey, so it is usually necessary to follow the legal definition when classifying a financing structure as debt or equity, and to identify the respective tax implications.

The principles underlying these approaches are discussed below.

## Debt

There is no limit on the amount of debt that can be put into a Turkish company and no general restriction on the deductibility of interest. Interest expenses incurred for business purposes are deductible on an accrual basis.

Interest expenses incurred for financing an asset acquisition need to be capitalized as the depreciated cost of the asset until the end of the year in which the asset is acquired. Interest expenses incurred thereafter can either be recognized as period expenses or capitalized.

The deductibility of interest may be restricted by thin-capitalization or transfer pricing rules (see later in the chapter).

It should be noted that debt financing from a foreign source may attract a surcharge (at 3 percent) if it is in the form of a foreign loan with an average maturity of less than one year. This can be avoided by structuring the loan in foreign currency with an average maturity of more than a year.

On the other hand, debt financing from a local source in Turkey (such as a bank) does not attract such surcharge, but the interest payments may be subject to a banking transaction tax generally at 5 percent.

## Deductibility of Interest

As noted above, Turkish tax laws do not impose a general restriction on deductibility of interest, but there are specific restrictions as explained below:

### Thin-Capitalization Rules

If the amount of debt (measured at anytime during the year) provided to a Turkish entity by its shareholders (or related parties) exceeds three times of the equity (that is, shareholders equity measured as per the statutory accounts opening balance sheet of the period concerned) the excess of debt above the 3:1 ratio is re-characterized as disguised equity. As a consequence of this thin-capitalization status:

- any financial expenses incurred on the disguised equity (related-party debt exceeding three times shareholders equity) cannot be deducted for corporate tax purposes; and
- the interest actually paid on the disguised equity is re-characterized as disguised dividends and subject to dividend WHT at 15 percent (unless reduced by a double taxation treaty [DTT]).

Note that an injection of equity or reserves to the company within a period does not help to overcome the thin-capitalization status for the current period, because the shareholders equity is measured as of the opening balance sheet, but it may help for subsequent periods.

When debt is obtained from an external bank against cash guarantees provided by the shareholders, thin-capitalization rules still apply.

### Transfer Pricing Rules

When a Turkish entity receives funding from its shareholders (or related-parties), the interest and other expenses charged on the loan should be shown to be arm's length. Any excess paid by the Turkish entity above the arm's length rate cannot be deducted for corporate tax purposes. Furthermore, such excess amount is re-characterized as disguised dividends and subject to dividend WHT at 15 percent (unless reduced by a DTT).

Turkey's transfer pricing regulations are similar to Organization for Economic Cooperation and Development (OECD) guidelines; hence any report or documentation prepared in a foreign country employing the same rules should normally be suitable as supporting documents in Turkey.

### Interest Incurred on Share Acquisition

As a general rule, expenses incurred for the purpose of tax-exempt activities are not deductible against income from other taxable activities of a company. This was a typical problem for a holding company with interest expenses incurred for the purpose of acquiring shares in another Turkish entity, which will potentially lead to tax exempt dividend and capital gains income.

A provision in the new Corporate Tax Law stipulates that a holding company in a similar position has the right to deduct such interest expenses against taxable income derived from other activities. But since, in practice, a pure holding company does not generate other taxable income, interest expenses carried forward as tax losses may expire after the carry forward period of five years. This may require further post-acquisition structuring.

## Withholding Tax on Debt and Methods to Reduce or Eliminate

Interest payments to non-resident corporations are subject to WHT (varying from 0 percent, 1 percent, 5 percent, to 10 percent). The WHT rate is reduced to 0

percent, if the interest is paid to a lender who qualifies as a foreign bank or financial institution.

It should be also noted that the interest payments to foreign parties other than banks may attract 18-percent VAT on a reverse-charge basis if the foreign party receiving the interest does not qualify as a bank or financial institution. There will be also a stamp tax of 0.75 percent on the loan contract, unless the loan is received from a bank or financial institution.

Therefore, it is usually less efficient to borrow directly from the Turkish entity and its foreign parent/group entity, but these tax inefficiencies may be eliminated through some additional structures.

The new Corporate Tax Law introduced anti-avoidance rules for transactions with entities in low-tax jurisdictions ("tax heavens"), by imposing a 30-percent WHT on various types of payments to residents of those jurisdictions (a list of these countries is yet to be issued by the Ministry of Finance). The impact of these rules on the ultimate WHT application should be noted.

### **Checklist for Debt Funding**

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- The use of external bank debt may avoid thin-capitalization and transfer pricing problems, but debt obtained from an external bank against cash guarantee provided by the shareholders, is still subject to thin-capitalization rules.
  - The use of external bank debt (even with a guarantee by shareholders) should eliminate the WHT and VAT implications on interest payments, unless the structure is open to challenge on substance grounds.
  - The absence of tax grouping means interest expenses incurred by a holding company in Turkey cannot be offset against taxable profits of the target, but can be carried forward as tax loss to be offset against any other taxable gains that may be arise in future.
  - Injection into the equity and reserves of the Turkish entity in one year is only included in the debt/equity calculation for the following year. This means that when considering the required related-party debt capacity of the following year, any required injection to equity or reserves by the shareholders needs to be completed before the end of the current period.
  - It is possible that tax deductions may be available at higher rates in other territories.
- A debt from a foreign source may attract a surcharge (at 3 percent) if it has an average maturity of less than one year.
  - A debt from a local source (such as a bank) in Turkey does not attract such a surcharge, but interest payments may be subject to a banking transaction tax, generally at 5 percent.

### **Equity**

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Equity injections are subject to a competition board fee of 0.04 percent, with no limit and including additional capital injections to the corporation. The fee is also payable on capital in-kind contributions. No other taxes or duties are levied on equity funding.

However, the level of equity funding in a Turkish entity may need to be considered for other reasons, such as:

- More equity may lead to an increased legal reserve requirement in the entity (as a percentage of the equity), and so reduce the dividend capacity.
- Equity is less flexible should the parent subsequently wish to recover the funds, because the reduction of equity in a Turkish company is subject to a regulated process that requires, amongst other things, the approval of a Trade Court.
- In view of Turkey's thin-capitalization rules (3:1 debt-to-equity ratio) a tax-efficient related party financing structure may require a review of the equity level in the entity.
- There may be also other non-tax grounds for preferring equity. For example, in certain circumstances it may be desirable for a company to have a pre-determined debt-to-equity ratio. This may apply to companies subject to industrial regulations (such as. a Turkish holding company of a bank or insurance company), or that expect to submit public bids (such as. privatization projects or license applications)

### **Tax Free Reorganizations**

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Turkish Corporate Tax Law allows for tax free mergers, divisions, and share swaps provided that certain procedural obligations are complied with. The main feature of such tax neutral reorganization is that it should be performed on the basis of book values (that is, no step up for the value of the assets) and the historical tax liabilities, if any, are assumed by the surviving entities.

## Hybrids

Hybrid financing instruments are not recognized for tax purposes in Turkey, so it is usually necessary to follow legal definitions to classify a financing structure as debt or equity, and determine the respective tax implications.

The thin-capitalization rules will also need to be considered, if the lender is a related-party.

## Discounted Securities

The tax treatment of securities issued at a discount differs from the accounting treatment in that the issuer cannot obtain a tax deduction on the difference in between nominal and discounted values unless the limits are allowed by the law and the authority granted by the law. In Turkey the main borrower is the government and there are few private debt securities issued by private sector.

## Deferred Settlement

An acquisition often involves an element of deferred consideration, the amount of which can only be determined at a later date on the basis of the business' post-acquisition performance. The right to receive an unknown future amount is not regarded as an asset that must be valued for Turkish tax purposes. Such amounts should represent a part of the transaction (as a tax triggering event) at the date when the due amounts can be calculated and claimed by the parties according to the terms and conditions of the contract.

For example, in a normal share acquisition structure, the deferred settlement amounts should be included in the final purchase price as a price adjustment and may be subject to tax or exempted, depending on the tax status of the original transaction.

## Other Considerations

Turkey does not normally tax the gains of non-residents except when the non-resident has a permanent establishment or a permanent representative in Turkey and the income can be attributed. A specific tax regime applies to capital gains derived from disposal of shares by a non-resident. The gain on sale of shares/participation rights of a company in Turkey may become taxable in Turkey:

- if the transaction occurs in Turkey; and
- if the transaction is valued in Turkey.

Such transactions have to be evaluated for Turkish tax purposes, depending on the status of the buyer and the seller, the type of the entity whose shares are being

transferred, and the method used to effect the share transfer.

## Concerns of the Seller

The seller is liable to tax on gains realized on the sale of the assets of a business. Losses arising from the sale of assets are available for immediate deduction or carry-forward.

The seller is liable to tax on gains arising from the sale of shares. Losses are available to offset income from other activities of the corporation.

Seventy-five percent of the gains derived from sale of real estate property or sale of shares of a Turkish company by another Turkish company may be exempted from corporate taxation provided the real estate property or the shares have been held for at least two years and the gains enjoying the exemption are retained in a special reserve account for five years. This requirement not to repatriate funds for five years may be impossible to satisfy, of course, if the seller plans to leave the business entirely.

Since gains derived by a Turkish individual from the sale of shares of a Turkish A.S. after a holding period of two years are fully tax exempt, such a seller would strongly oppose structuring the transaction as asset deal, or would expect the tax liabilities arising on an asset deal to be borne by the purchaser by way of a corresponding increase in purchase price.

Moreover, apart from taxation reasons, a seller in need of cash would be reluctant to agree to an asset deal, because the repatriation of cash from the selling entity to its shareholders would also pose some problems:

## Company Law and Accounting

A foreign company may do business in Turkey in one of the following ways: operate as a contractor, establish a branch, or form a subsidiary. All are subject to the provisions of Turkish Commercial Code.

The uniform chart of accounts (as defined by the Turkish Tax Procedural Code) is compulsory for all companies except those subject to regulatory and/or supervisory agencies, which should use Turkish Financial Reporting Standards (TFRS) for their sectors, such as banks, brokers, and insurance, leasing, and factoring companies. TFRS are aligned with International Financial Reporting Standards (IFRS). The annual accounts for all companies must include an income statement, a balance sheet, and notes to each. Accounts must be drafted and approved by the general shareholders

meeting within three months of the end of the financial period.

There is a draft bill in Parliament to change the Turkish Commercial Code, which is expected to establish IFRS as the statutory accounting requirement for Turkish companies as well.

### **Group Relief/Consolidation**

Consolidation for tax purposes is not allowed. Each entity is subject to tax on a stand-alone basis.

### **Transfer Pricing**

Turkey introduced transfer pricing regulations to its Corporate Tax Law effective from 2007. They are generally in alignment with the OECD model. The regulations are applicable to both domestic and cross-border transactions between related parties, but a transfer pricing adjustment is not required for domestic transactions between Turkish tax-registered entities as long as there is no ultimate fiscal loss for the government.

The regulations require that prices, fees, and charges for inter-company transactions (including interest on intra-group financing) should be determined on an arm's length basis, as determined by an acceptable methodology.

### **Dual Residency**

Dual residency status is not directly referred to or explained in Turkish tax laws and is not, therefore, relevant for structuring an M&A transaction in Turkey, from a Turkish tax perspective.

### **Foreign Investments of a Local Target Company**

Turkey has introduced a controlled foreign company (CFC) regime in the new Corporate Tax Law. CFC status is determined by a number of criteria, but normally an operating company with an active business should not be classified as a CFC. On the other hand, an intermediary holding company owned by a Turkish company is likely to be deemed a CFC if the intermediary holding benefits from a participation exemption regime, and is thus not effectively paying taxes, in its territory. The acquisition of shares in a Turkish target should not lead to a change in the CFC status of its foreign investments.

Turkey also introduced a holding regime in the new Corporate Tax Law, to encourage holding foreign investments through a company established in Turkey. The form of the company can be the usual A.S. or Ltd.

There are no particular requirements from a Company Law perspective to qualify as a holding company.

If the holding company meets the conditions stipulated in the Corporate Tax Law, the dividends and potential capital gains on investments by the Turkish target can be fully exempt from corporate taxes. Furthermore, the dividend WHT to be applied during the ultimate repatriation of profit from the Turkey target to its shareholders is reduced by 50 percent (that is, 7.5 percent instead of 15 percent).

## **Comparison of Asset and Share Purchases**

### **Advantages of Asset Purchases**

- Purchase price can be depreciated or amortized for tax purposes.
- Step-up in tax basis (through revaluation) is obtained.
- Previous liabilities of the seller are not inherited.
- Possible to acquire part of the business.
- More flexibility in funding.
- Absorbing a profitable business into a loss-making company is possible.

### **Disadvantages of Asset Purchases**

- Potential need to renegotiate existing agreements, and renew licenses, among others.
- More transaction costs (such as stamp taxes and title deed registration fees).
- Exemptions on sale of shares are not applicable.
- Tax losses remain with the seller.
- Not favorable for the seller in terms of cash flow.

### **Advantages of Share Purchases**

- Purchase on net-asset basis, so lower capital outlay.
- Likely to be more attractive to the seller due to available tax exemptions and cash flow.
- Acquire the tax attributes of the target (that is, tax losses).
- Continue to enjoy existing contracts and licenses, among others.

**Disadvantages of Share Purchases**

- Acquisition of potential tax liability (difference between market value and tax basis of assets in the target company, which would be crystallized on disposal of such assets).
- Inability to recognize goodwill available for tax depreciation.
- Acquisition of contingent (unknown) tax liabilities of the target.

**Withholding Tax Rate Chart**

The rate information and footnotes contained in this table are from the 2009 IBFD/KPMG Global Corporate Tax Handbook.

Country	Dividends		Interest <sup>1</sup> (%)	Royalties (%)
	Individuals, Companies (%)	Qualifying Companies <sup>2</sup> (%)		
Albania	15	5	10	10
Algeria	12	12	10	10
Austria <sup>20</sup>	35	25	15	10
Azerbaijan	12	12	10	10
Bahrain	15	10	10	10
Bangladesh	10	10	10	10
Belarus	15	10	10	10
Belgium	20	15 <sup>17</sup>	15	10
Bosnia and Herzegovina	15	5	10	10
Bulgaria	15	10	10	10
China (People's Rep.)	10	10	10	10
Croatia	10	10	10	10
Czech Republic	10	10	10	10
Denmark	20	15	15	10
Egypt	15	5	10	10
Estonia	10	10	10	5/10 <sup>3</sup>
Ethiopia	10	10	10	10
Finland <sup>22</sup>	20	15	15	10
France	20	15 <sup>4</sup>	15	10
Germany <sup>18</sup>	20	15 <sup>4</sup>	15	10
Greece	15	15	12	10
Hungary	15	10	10	10
India	15	15	10/15 <sup>5</sup>	15
Indonesia	15	10	10	10
Iran	20	15	10	10
Israel	10	10	10	10
Italy	15	15	15	10
Japan	15	10 <sup>6</sup>	10/15 <sup>5</sup>	10
Jordan	15	10	10	12
Kazakhstan	10	10	10	10
Korea (Rep.)	20	15	10/15 <sup>7</sup>	10
Kuwait	10	10	10	10
Kyrgyzstan	10	10	10	10
Latvia	10	10	10	5/10 <sup>3</sup>
Lebanon	15	10 <sup>8</sup>	10	10
Lithuania	10	10	10	5/10 <sup>3</sup>
Luxembourg <sup>9,21</sup>	20	10	10/15 <sup>7</sup>	10
Macedonia	10	5	10	10
Malaysia	15	10	15	10
Moldova	15	10	10	10
Mongolia	10	10	10	10
Morocco	10	7	10	10
Netherlands	20	15 <sup>16</sup>	10/15 <sup>7</sup>	10

Country	Dividends		Interest <sup>1</sup> (%)	Royalties (%)
	Individuals, Companies (%)	Qualifying Companies <sup>2</sup> (%)		
Northern Cyprus Turkish Republic	20	15	10	10
Norway	30	25	15	10
Pakistan	15	10 <sup>10</sup>	10	10
Poland	15	10	10	10
Portugal	15	5 <sup>11</sup>	10/15 <sup>7</sup>	10
Qatar	15	10	10	10
Romania	15	15	10	10
Russia	10	10	10	10
Serbia <sup>15</sup>	15	5	10	10
Singapore	15	10	7.5/10 <sup>5</sup>	10
Slovak Republic	10	5	10	10
Slovenia	10	10	10	10
South Africa	15	10	10	10
Spain	15	5	10/15 <sup>12</sup>	10
Sudan	10	10	10	10
Sweden	20	15	15	10
Syria	10	10	10	10/15 <sup>13</sup>
Tajikistan	10	10	10	10
Thailand	15	10	10/15 <sup>5</sup>	15
Tunisia	15	12	10	10
Turkmenistan	10	10	10	10
Ukraine	15	10	10	10
United Arab Emirates	12	10 <sup>19</sup>	10	10
United Kingdom	20	15	15	10
United States	20	15 <sup>14</sup>	10/15 <sup>5</sup>	5/10 <sup>3</sup>
Uzbekistan	10	10	10	10

## Notes

- Many treaties provide for an exemption for certain types of interest, such as interest paid to the state, local authorities, the central bank, export credit institutions, or in relation to sales on credit. Such exemptions are not considered in this column.
- The rate given in this column generally applies if the non-resident company owns at least 25 percent of the capital of the Turkish company.
- The lower rate applies to equipment leasing.
- This rate applies if the non-resident company owns at least 10 percent of the capital of the Turkish company.
- The lower rate applies to interest paid to a financial institution.
- This rate applies if the Japanese company has owned at least 25 percent of the voting shares of the Turkish company for six months immediately before the end of the accounting period for which the dividends are paid.
- The lower rate applies to interest paid on a loan made for a period of more than two years.
- This rate applies if the Lebanese company owns at least 15 percent of the capital of the Turkish company.
- The treaty does not apply to income paid to exempt Luxembourg holding companies.
- This rate applies if the Pakistani company holds at least 25 percent of the capital of the Turkish company and the Turkish company is engaged in an industrial undertaking.
- This rate applies if the Portuguese company has owned directly at least 25 percent of the capital of the Turkish company for at least two years.
- The lower rate applies to interest on loans from credit institutions and interest in relation to sales on credit.
- The lower rate applies to copyright royalties.
- This rate applies if the U.S. company owns at least 10 percent of the voting shares of the Turkish company.
- The treaty concluded between Turkey and the former Serbia and Montenegro applies between Turkey and Serbia. Its applicability between Turkey and Montenegro has yet to be clarified.
- The protocol of the tax treaty limits the maximum applicable WHT rate on dividends to 10 percent in Turkey and 5 percent in the Netherlands as soon as the participation exemption is applied in the Netherlands.
- The protocol of the tax treaty limits the maximum applicable WHT rate on dividends to 10 percent in Turkey and 5 percent in Belgium.
- Germany has unilaterally terminated the German/Turkish double tax treaty (announced on 7 August 2009). The double tax treaty will continue to be in place during calendar year 2010 and termination will be effective starting from 1 January 2011. It is expected that the countries will enter into a new tax treaty before that date.
- If the receiver of the dividend is a public institution held by the government of the other contracting state or its sub-branches, the dividend WHT applicable is reduced to 5 percent.
- The treaty between the parties has been revised and concluded on 28 March 2008. The new treaty will be applied effective from 1 January 2010. However, Austria and Turkey are expected to sign a new protocol to the treaty in due course.
- The protocol to the treaty between Luxembourg and Turkey signed on 6 October 2009 has implemented internationally agreed tax standards on exchange of information for tax purposes.
- Finland and Turkey signed an income tax treaty and protocol on 6 October 2009. Once in force, the new treaty will replace the Finland-Turkey income tax treaty and protocol of 9 May 1986.

**KPMG in Turkey**

Abdulkadir Kahraman  
Yetkin Yeminli Mali Müsavirlik A.S.  
Büyükdere Cad. Yapi Kredi Plaza  
C Blok, K: 5  
Levent  
Istanbul  
34330  
Turkey

Tel. +90 (212) 317 74 50 x 414  
Fax +90 (212) 317 73 00  
e-Mail: akahraman@kpmg.com.tr

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