TAX SYSTEM

The Turkish tax regime can be classified under three main headings:

Income Taxes

Corporate Income Taxes

Individual Income Taxes

Taxes on Expenditure

Value Added Tax

Banking and Insurance Transaction Taxes

Stamp Duty

Taxes on Wealth

Inheritance and Gift Taxes

Property Tax

INCOME TAXES

Income taxes in Turkey are levied upon the income, both domestic and foreign, of individuals and corporations resident in Turkey. Non-residents earning income in Turkey through employment, ownership of property, carrying on a business or other activities giving rise to income are also subject to taxation, but only on their income derived in Turkey.

Corporate Income Tax:

For tax purposes, companies are grouped as limited liability companies (corporations and limited companies) and personal companies (limited and ordinary partnerships). Corporate tax applies to limited liability companies. State economic enterprises and business entities owned by societies, foundations and local authorities are also subject to corporation tax.

Whether a company is subject to full or limited tax liability depends on its status of residence. A company, whose statutory domicile or place of management are established in Turkey (resident company), will have full tax liability; in this case, worldwide income is taxable. If a non-resident company conducts business through a branch or a joint venture, it will have limited tax liability; i.e. fully subject to corporate tax on profits earned in Turkey on an annual basis. If there is no presence in Turkey, withholding tax will generally be charged on income earned; for example, for services provided in Turkey. However, if there is an avoidance of double taxation treaty, reduced rates of withholding tax may apply.

The basic corporate income tax rate levied on business profits is 30% in Turkey. Dividend withholding tax is also applied in the event of profit being distributed to share holders. For resident corporations, tax is levied on worldwide income, but credit is given for foreign tax payable in respect of income from foreign sources (up to the amount of Turkish corporate income tax, i.e. 30%)

Corporate entities having their statutory domicile and place of management outside Turkey, but established in Turkey in the form of a branch are subject to tax on an annual return based on income received from the permanent establishment in Turkey.

From the non-resident's point of view, many payments abroad including those for professional services and technical assistance, royalties and rentals are subject to withholding tax at rates varying between 10% to 25%.

In this regard, countries having avoidance of double taxation treaties with Turkey have considerable advantages. Turkey has signed such treaties with 60 countries and the investors of these countries can benefit from a reduction in withholding taxes. Countries with which Turkey has bilateral tax treaty agreements came into force as of April 2005 are as follows:

- Albania
- Algeria
- Austria
- Azerbaijan
- Belarus
- Bangladesh
- Belgium
- Bulgaria
- Czech Republic
- Croatia
- China
- Denmark
- Egypt
- Estonia
- Finland
- France
- Germany
- Greece
- Hungary
- India
- Indonesia
- Israel
- Italy
- Japan
- Jordan
- Kazakhstan
- Kyrgyzstan
- Kuwait
- Latvia
- Lithuania
- Luxemburg
- Macedonia
- Malaysia
- Moldova
- Mongolia
- Netherlands
- Norway
- Pakistan
- Poland
- Romania
- Russia
- Saudi Arabia (*)
- Singapore
- Slovakia
- Slovenia
- South Korea
- Spain
- Sudan
- Sweden
- Syria
- T.R. of Northern Cyprus
- Tajikistan
- Thailand
- Tunisia
- Turkmenistan
- Ukraine
- United Arab Emirates
- UK
- USA
- Uzbekistan

**This agreement covers only air transportation activities.*

Individual Income Tax:

The limited tax liability covers trade or business income from a permanent establishment, salaries for work done in Turkey (regardless of where paid or whether or not remitted to Turkey), rental income from real property in Turkey, Turkish derived interest, and income from the sale of patents, copyrights and similar intangible assets. The personal income tax rate varies from 15% to 40%.

TAXES ON EXPENDITURE

Value Added Tax (VAT):

The generally applied VAT rate is 18%. VAT payable on local purchases and on imports is regarded as "input VAT" and VAT calculated and collected on sales is considered as "output VAT". Input VAT is offset against output VAT in the VAT return filed at the related tax office by the 23rd of the following month. If output VAT is in excess of input VAT, the excess amount is paid to the related tax office. On the contrary, if input VAT exceeds the output VAT, the balance is carried forward to the following months to be offset against future output VAT. There is no cash refund to recover excess input VAT, except for exportation.

There is also a so-called reverse charge VAT mechanism, which requires the calculation of VAT by resident companies on payments sent abroad. Under this mechanism, VAT is calculated and paid to the related tax office by the Turkish company on behalf of the foreign company.

The local company treats this VAT as input VAT and offsets it in the same month. This VAT does not create a tax burden for the Turkish and the non- resident company, except for its cash flow effect.

Special Consumption Tax:

In Turkey, Special Consumption Tax was implemented in August 2002 by abolishing 16 different indirect taxes and funds. By introducing this tax, the direct tax system of Turkey became in line with the European Union directives. There are mainly 4 different product groups that are subject to special consumption tax at different tax rates:

- Petroleum products, natural gas, lubricating oil, solvents and derivatives of solvents
- Automobiles and other vehicles, motorcycles, planes, helicopters, yachts
- Tobacco and tobacco products, alcoholic beverages
- Luxury products

Unlike VAT, which is applied on each delivery, special consumption tax is charged only once.

Banking and Insurance Transaction Tax:

Banking and Insurance company transactions remain exempt from VAT, but are subject to a Banking and Insurance Transaction Tax. This tax applies to income earned by the banks, for example on loan interest.

Stamp Duty:

Stamp duty applies to a wide range of documents, including contracts, agreements, notes payable, capital contributions, letters of credit, letters of guarantee, financial statements and payrolls. Stamp duty is levied as a percentage of the value of the document at rates ranging from 0.15% to 0.75%.

TAXES ON WEALTH

Inheritance and Gift Taxes:

Items acquired as gifts or through inheritance are subject to taxes between 1% and 30% of the item's appraised value. Tax paid in a foreign country on inherited property is deducted from the taxable value of the asset. Inheritance tax is payable over the period of three years and in two installments per year.

Property Taxes:

Property taxes are paid each year on the tax values of land and buildings at rates varying from 0.1% to 0.6%. In the case of the sale of property, a 1.5% levy is paid on the sales value by both the buyer and the seller. The rate is also applied as 1.5% if the property is contributed as capital-in-kind.

Buildings and lands owned in Turkey are subject to real estate tax at the following rates:

- Residences 0.1%
- Other buildings 0.2%

Withholding Tax:

Under the Turkish tax system, certain taxes are collected through withholding by the payers in order to secure the collection of taxes. These include income tax on salaries of employees, lease payments to individual landlords, independent professional service fee payments to resident individuals, and royalty, license and service fee payments to non residents.

For more detailed information about tax system in Turkey, please visit the below link for the report prepared by Price Waterhouse Coopers Turkey.
PWC a General Tax Guide-December2004