

Turkey

Mergers and Acquisitions
December 2004

Turkey – Mergers and Acquisitions

This booklet was prepared by PricewaterhouseCoopers Turkey to provide investors in Turkey with a broad outline of the tax regulations of mergers and acquisitions. It reflects the current tax law or practice in Turkey as of December 2004.

This booklet is not intended for definitive investment advice but merely as an explanatory guide. We would strongly recommend that readers seek professional advice before making any decisions. The fact that Turkish tax regulations are subject to frequent changes should also be borne in mind.

For further information, please contact the PricewaterhouseCoopers office in Turkey (see Appendix I).

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Introduction

This booklet is prepared to provide information regarding the main issues relevant to both purchasers and sellers on the transfer of ownership of a Turkish company, which usually takes place in the form of an asset or share deal. Mergers and de-mergers may also be considered, although the current Commercial Legislation does not provide adequate guidelines for performing certain types thereof.

ACQUISITIONS

1 The Preference of Purchasers: Assets vs. Shares

1.1 Asset Acquisition

Historic Tax and Commercial Liabilities

Acquisition of assets of the target company generally enables the purchaser to avoid exposure to the risk of any historic tax and commercial liabilities. Liabilities associated with the assets under purchase generally lie with the seller company. However, should the tax administration prove that the purchaser has entered into an unlawful transaction with the intention of assisting the seller to avoid paying tax liabilities, there is a probability that the asset transfer contract being cancelled by the Court, if the seller cannot pay its tax liabilities following the transaction.

Existing Contracts of the Company

In an asset acquisition, the contracts between the seller and third parties are not automatically transferred to the purchaser. Thus the purchaser should either enter into new contracts with the third party or acquire the consent of the third parties to carry on the existing contract with the titles of the seller. Note that in practice, the purchaser may face difficulties regarding this issue.

Transfer of Employees

In the event of transfer of the personnel to the purchaser company, severance payment is the main issue of consideration. Although in principle the seller party is responsible for making the severance payment to the employees, whereas it may be settled during the asset acquisition that the purchaser will be liable for the severance payment, as a part of the purchase price. It is also possible to not actually pay the severance payment, but to acquire a signed document from the personnel showing that they would work for the purchaser party and that their total severance payment right would be transferred to the purchaser party, should they quit the company later on. The purchaser may opt to obtain a certain warranty from the seller for the substitution of the severance payment liability, regarding the period the employee worked for the seller party.

Step-up in the value

An asset acquisition enables a step-up in the tax basis of assets in the purchaser company. The purchaser may depreciate the fixed assets over their purchase value, regardless of their accumulated depreciation in the seller company. Goodwill, if transferred as a separate item on the invoice, is considered and recorded as an intangible asset in the statutory books of the purchaser company and is depreciated in equal instalments over a five-year period.

Taxation

The proceeds from the asset transfer are considered as a part of the commercial income of the seller company and create a corporate tax liability for the seller company. From the perspective of the shareholders of the seller company, these proceeds are only attainable through dividend distribution over the after tax profit, provided that the seller company is a profit making company. This may mean a “double taxation” of the proceeds, as income withholding tax may be payable over the dividends distributed and the dividend recipient may be required to pay additional taxes, depending on the nature of the shareholder. (Please see section 6.1 on “Repatriation of Profits”)

1.2 Share Acquisition

Historic Tax and Commercial Liabilities

In the event of the acquisition of shares of the target company, together with the future liabilities, the purchaser would undertake all the historic tax liabilities of the target until the end of the statute of limitation, which is five years according to Turkish tax legislation. There is no step-up permitted in the tax base cost of the company's assets. However, the purchaser may preserve and enjoy the tax attributes of the target company as the legal personality of the company will not change and the change in the shareholding structure does not affect the tax attributes.

Business and other non-tax liabilities of the target company would also be transferred to the purchaser, together with the contracts of the target company with third parties. This may be more desirable for the purchaser, especially in the event of acquisition of contracts and licenses specific to the target company. In principle, these documents remain in force after the share transfer and thus their assignment or renegotiation is not needed.

Taxation

Through the share acquisition, the shareholders of the target company directly acquire the proceeds of the share transfer. This capital gain generated by the shareholder is, in principle, taxable under Turkish Income Tax Law. (Please see section 7.1 on "Share Disposals")

There is usually a potential conflict of interest between the purchaser and seller because if the seller is an individual (which is usually the case since most of the companies in Turkey are family owned) there is a capital gains exemption after a one-year holding period for shares. On the other hand, acquisition of assets is preferable from the purchaser's perspective since it provides step-up opportunities for tax purposes and is a way of side-stepping past risks of the target company.

2 Transaction Costs for Purchasers

2.1 Transfer Taxes

2.1.1 Share purchase

(a) VAT

There is no VAT liability regarding the share transfer transaction.

(b) Stamp duty

Stamp tax should be calculated over the sales price indicated in the share sales/purchase agreement at a rate of 0.75%. Note that each and every signed copy of the agreement is separately subject to stamp tax.

According to the stamp duty regulations, for the agreements signed in Turkey, a taxable event occurs when the documents are signed. In the case of agreements signed abroad, it may be claimed that no stamp tax arises until the agreement is brought into Turkey to be submitted to the official departments or until the terms of the document are benefited from in Turkey. The definition of “benefiting from the terms of the agreement “ is considered to be very broad, and in principle, if at least one of the parties is resident of Turkey, stamp tax is due.

Please note that there is no differentiation made for the party liable for tax in the Stamp Tax legislation and both parties of the transaction are held jointly responsible. In practice, the parties come to a mutual agreement regarding the payment of stamp tax.

Stamp tax amount calculated per each agreement may not exceed TRL 1,028,000,000,000 (approximately USD 720,000 at the foreign exchange rate valid in December 2004) as of December 2004.

There is a requirement stemming from Commercial Code that share purchase agreements relating to limited companies (Ltd.) should be notarised whereas no such condition exists for transfer of joint stock company (A.S.) shares. Please note that stamp duty is not applied on share purchase agreements of limited companies but there is a notary fee.

2.1.2 Asset purchase

(a) VAT

The transfer of assets would be subject to VAT at the general rate of 18% over the purchase value of the assets. The VAT rate may differ depending on the nature of the assets. The applicable VAT rates are 1%, 8% and 18% currently. For example, second hand cars are subject to the rate of 1%. There are certain methods available for reducing the VAT liability on asset transfer, such as financial leasing or transfer of assets through an Investment Incentive Certificate.

The purchaser is able to deduct VAT paid on asset acquisition through the offset mechanism as described below.

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 20th 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 a few situations such as exportation and sales to an investment incentive holder.

(b) Real Estate Transfer Tax

The transfer of the legal title of a real estate in Turkey is subject to 1.5% real estate transfer tax over the purchase price. This charge is applied separately for the acquirer and the seller. Thus, the total charge over the property that has to be paid would be 3%.

(c) Stamp duty

Agreements signed in relation to transfer of assets are subject to stamp tax as explained in section 2.1.1.(b)

In the event of the transfer of any kinds of commercial and non-commercial agreements of the seller to the purchaser with the same terms and conditions, stamp tax liability would emerge over the highest monetary figures cited on the relevant agreements at the rate of one fourth of the standard rate of 0.75% (i.e. 0.1875 %).

2.3 Tax Deductibility of Transaction Costs

(a) Share purchase

Financial expenses

Financial expenses incurred in order to finance the purchase of shares of a company are treated as deductible expense for corporate income tax purposes.

Other expenses

Other expenses such as due diligence, consultancy and research expenses incurred in order to purchase the shares of a company are also recorded as deductible.

(b) Asset purchase

Financial expenses

Financial expenses relating to loans which are used to finance fixed assets must be accumulated until the end of the year of capitalisation of such assets and capitalized as a part of the cost. However, it is optional to capitalise the interest and foreign exchange losses incurred after the end of the year of capitalization, which are related to the loans used to finance such assets.

Other expenses

The expenses listed below should also be included in the cost of the asset:

- Customs duties, transportation and installation charges for machinery and equipment,
- Expenses arising from the purchase and demolition of an existing building and the leveling of its site.

Companies in Turkey are free to include expenses for public notaries, court fees, assessment, commissions, and public announcements as well as for Real Estate Transfer Tax in the cost of the assets or to treat them as a general expense.

VAT paid on transaction related expenses is in principle recoverable for both asset and share purchases. Banking and Insurance Transaction Tax (BITT) is also deductible for corporate income tax purposes. Please see section 4.1.b for further information on BITT.

3 Basis of Taxation Following Asset or Stock Acquisition

3.1 Share Acquisition

(a) Purchase price

For the purchaser, the main cost is the purchase price of the shares of the acquired company. Note that there is no obligation to have a formal valuation made of the target company. However, it is required that the purchase price of the company be determined at fair market value and the transaction be executed on an “arms’ length” basis.

The underlying base costs of the assets of the acquired company are not changed and there is no possibility available to step up the basis of assets. In case of share purchase, goodwill is not deemed to arise under the Turkish tax and accounting rules. Instead, the full consideration paid is considered as the acquisition cost of the share.

(b) Tax grouping

Turkey has a separate entity basis of taxation, and thus tax grouping is not possible under Turkish taxation legislation either for corporation tax or VAT.

3.2 Asset Acquisition

The purchaser company may realize a step-up in the tax basis of the transferred assets. The fixed assets that are transferred may be depreciated over their purchase values, regardless of their accumulated depreciation in the seller company.

It is possible to calculate depreciation over the purchase value of the assets (excluding vacant land and vacant plots), using depreciation rates based on the useful life declared by the Ministry of Finance. Note that this rate may be doubled by the utilization of the double declining depreciation method but the rate cannot exceed 50%. Buildings are depreciated over a period from 10 to 50 years.

The purchase price is allocated by the seller on the invoice over the assets up to their individual market values. The balance will be considered as goodwill. Goodwill is recorded as an intangible asset in the statutory books of the purchaser company and is depreciated in equal instalments over five years.

Sales of inventory are included in the commercial profits of the seller company. These transferred inventories would be recorded into the statutory books of the purchaser company over their purchase values. These values can be adjusted according to Wholesale Price Indices during the high inflation periods under the inflation accounting rules.

It is required that the purchase price of the assets be determined over fair market values. It may be advisable especially in case of related party transactions to ask the commercial court to value the assets to avoid the risk of a challenge by the tax authorities, with consequent additional tax assessments, penalties and late payment interest.

4. Financing of Acquisitions

4.1 Debt

Specific tax issues relating to the overall level of borrowings and the interest charged on this debt are as follows:

(a) Withholding tax

The interest on inter-company loans obtained from abroad will be subject to a withholding tax of 10% based on the opinion of the Tax Authorities. However, there is no withholding tax on foreign loans obtained from banks or other financial institutions. In addition there is no withholding tax liability on the loans obtained from a local bank or other local companies (except for few limited cases ordinary Turkish companies are not allowed to extend loans).

(b) VAT

In line with the provisions of the Value Added Tax Law, interest payments on the loans obtained from any foreign company other than banks or financial institutions are subject to 18% VAT, which has to be calculated and paid by the local company under the so-called “reverse charge mechanism”. This VAT is then treated as input VAT by the local company and is offset against the output VAT of the same month. This VAT does not create any tax burden for either the Turkish or the non-resident company, except for its cash flow effect for the former (in case there is not enough output VAT of the Turkish entity to offset therefrom). Note that there is no VAT liability on interest payments on loans obtained from foreign banks and other financial institutions.

In the event of the loan being extended through a local bank, although there will be no VAT liability, Banking and Insurance Transaction Tax (BITT) at %5 calculated over the interest amount is payable by the bank. In practice, banks pass this obligation onto their customers.

(c) Resource Utilization Support Fund

Foreign loans obtained by Turkish resident individuals or legal entities other than banks or financial institutions are subject to Resource Utilisation Support Fund (RUSF) at the rate of 3% of the principal amount, payable at the time of the transfer of the loan. RUSF levy can be avoided by setting the average maturity of the hard currency loan obtained from abroad as longer than one year.

(d) Deductibility of interests

In principle, interest payments are tax deductible; however, note that the deduction of interest and other financial expenses arising from a loan may not be possible if the loan is deemed as thin capital. (Please find the detailed explanations on thin capital in section 4.1.e)

(e) Thin Capitalisation

According to the Turkish legislation, the considerations for thin capital arises, if a loan is obtained from the related parties, the loan is continuously used within the company and the ratio of the loan to the shareholders’ equity is high in comparison to similar companies in the same sector. The last

two conditions are somewhat subjective and ambiguous causing different interpretations. The general understanding of the term “continuous use” of the loan is for a period longer than one year. In addition there is no specified debt to equity ratio given in the legislation. However, in principle the higher the ratio is, the higher the risk of thin capitalisation. Although many different opinions exist regarding this issue, the prevailing opinion is that thin capitalisation risk would be considered very high where this ratio exceeds 0.5 (1:2). The outcome of a loan being deemed as thin capital would be that interest expenses incurred on the loan are treated as non-deductible expenses for corporate tax purposes. Any foreign exchange losses occurred on such a loan may also be treated as non-deductible in determination of the tax base by the tax authorities.

4.2 Equity

(a) Capital taxes

There is no capital duty in Turkey. Capital contributions into a Turkish company are not subject to stamp duty but are subject to Competition Fund at 0.04% and the Consumer Protection Fund at 0.1% (which will be abolished as of 01 January 2005). These funds are applied on all capital increases including the establishment capital.

(b) Capital Inadequacy and Technical Insolvency

In the event of half of a company’s capital being lost or reduced as a result of operational losses or for other financial reasons according to the latest annual financial statements, then the board of directors should draw up an interim balance sheet using the market values of the assets as a basis. In a situation where the company has less than one third of the paid-up capital according to the interim financial statements prepared as such, then the board of directors is required to take action and notify the general assembly. The alternatives set out in the Commercial Code are:

- The general assembly may decide to complete the missing portion of the capital or decide to continue with the existing capital (capital deduction).
- Where the general assembly does not adopt a solution, by either adding capital, or continuing with the remaining one third of the capital, then if the assets of the company are not sufficient to cover the debts of the creditors, the board of directors must immediately inform the Commercial Court. Then the company may be considered insolvent by the Commercial Court.
- If it can be ascertained that the situation of the company could be improved, then the court may defer the adjudication of bankruptcy on application by the board of directors or by a creditor.

(c) Capital Deduction

Capital deduction is theoretically possible under the Turkish Commercial Code. On the other hand, capital deduction is not quite applicable in practice, except in the event of liquidation and demergers, due to the time-consuming bureaucratic process.

5 Mergers

5.1 Legal Forms of Mergers

According to the Turkish legislation, merger transactions should take place at market and/or net realisable value and tax would be payable on the resulting uplift over book values. Taxation would arise as the hidden reserves of the dissolving company are realised.

However, there is one specific exception to this principle defined as “take-over” by the Corporate Tax Law. Take-over is defined as the transfer of all the assets and liabilities of a company over their book values as of the date of take-over to another company. The main requirement for a take-over is that the legal or business centres of the two companies must be based in Turkey and that they must be of the same legal type. No taxation arises for the capital gains since the assets of the dissolving company are transferred to the absorbing company at book value. The absorbing company retains its rights as regards loss carryovers if the conditions cited in section 6.4(a) are realized.

Note that take-overs are free of taxation once the below conditions are fulfilled:

- Dissolving and absorbing companies must submit a tax return regarding the period before take-over for the dissolving company, which would be signed by both parties, to the tax office of the dissolving company within 15 days from the take-over and must attach the take-over balance sheet to this return.
- The absorbing company must undertake all the tax liabilities of the dissolving company that have been or will be incurred, together with other liabilities, through a declaration attached to the statement of transfer.

5.2 Tax Consequences

In the case of taxable mergers, any profit arising from the merger operation is subject to corporate tax at a rate of 30%. In addition, assets including inventories and goodwill, if any, transferred to the other parties would be subject to VAT. Note that the absorbing company cannot use “carried forward VAT” and losses of the dissolving company.

In the event of a tax-free “take-over”, only the taxable profit derived by the dissolved company until the take-over date will be subject to corporate tax. No taxation will arise due to the take-over. Note that take-over transactions are also exempted from VAT, stamp tax and any other fees except for the Competition Fund at 0.04% and the Consumer Protection Fund at 0.1% (which will be abolished as of 01 January 2005) applied on the amount of the capital increase at the merged company level.

6 Other Structuring and Post Deal Issues

6.1 Repatriation of Profits/Taxation of dividends

Dividends paid on shares are not tax-deductible in company paying dividends. Corporate withholding tax at the rate of 10 % is applicable to dividends distributed to individuals and non-resident entities (dividend distribution to the resident entities and branches of non-resident entities are not subject to corporate withholding tax). Please note that for non-resident companies (i.e. branches, permanent establishments) withholding tax will only be applicable on the portion of the branch profit that is transferred to headquarter. In other words, if the branch profit is not transferred to headquarter, no withholding tax will be applicable.

Note that in case the recipient of dividend is a resident company, there would be no further taxation whereas resident individuals are subject to income tax on the dividends received where a credit mechanism for the withholding tax is available.

6.2 Non-Core Disposals

Disposal of non-core assets is treated in the same way as disposal of a business line of the target company from a tax perspective. On the other hand, the disposal of a business line may have tax implications regarding the transfers realized under an investment incentive certificate. (Please see section 6.4.c)

Non-core business lines can be disposed of in a tax-free manner subject to certain conditions (please see section 10). The de-merger regulations require commercial integrity of the transferred production or service plants, meaning that the transferred portion should be readily available to commence operation with its total enterprise, fixed assets, and distribution network.

6.3 Cash Repatriation

The foreign exchange regulations are quite liberal in Turkey. Note that for foreign loans, banks seek the notification of the loan to the Turkish Central Bank during the transfer of the foreign loans back to the foreign company. Turkish resident entities cannot make cash loans available abroad. Dividends can be paid by Turkish companies, if available profits and distributable reserves exist. For dividend distribution purposes, the previous years' losses should be deducted from the current years profit before distribution. Service and royalty fees can be paid to foreign companies as long as transfer pricing rules are obeyed . Please see section 4.1 for foreign inter-company loans.

Please note that there is, except for listed companies, no interim dividend distribution possibility for Turkish companies.

6.4 Preservation of Existing Tax Attributes

(a) Carried Forward Tax Losses

According to the Turkish legislation, tax losses of the companies can be carried forward for five years until deducted from the profits generated in the following periods. In the event of share

acquisition, the purchaser would enjoy the carried forward tax losses of the target company. Note that this opportunity is not applicable for asset transfers.

Although existing tax attributes of the absorbed company are automatically transferred to the absorbing company under a take-over, the practice of merger differs from that of share acquisitions from the perspective of carried-forward tax losses. The following conditions must be fulfilled in order for the absorbing company to benefit from the carried-forward tax losses of the absorbed company:

- (i) Both the absorbing and the absorbed companies operate in the same industry.
- (ii) Corporate tax returns for the previous five years of the absorbed company be submitted to the tax office on time
- (iii) The loss amount that could be utilized by the absorbing company is limited to the total of the assets of the absorbed company as of the date of the merger.

(b) Carried Forward Deductible VAT

In the event of share acquisition, the purchaser would enjoy the carried-forward input VAT of the target company. Note that this option is not available in cases of asset transfers and taxable mergers.

(c) Transfer of Investment Incentives

Investment incentives available to the target company will be automatically transferred to the acquiring company in cases of share purchase and tax-free take-over. In case of the acquisition of individual assets, generally, investment incentives will not pass on to acquiring company. If the assets of a business line are acquired as a whole, investment incentives may be transferred to the purchaser provided that certain conditions are met.

(d) Other Tax Attributes

Other existing tax attributes of the target company, if any, are automatically transferred to the purchaser company in cases of share acquisition and tax-free take-over.

DISPOSALS

7 Disposals

Note that inflation accounting became applicable in Turkey as of 01.01.2004, and if implementation conditions are met, the book values of non-monetary items are adjusted with inflation rates.

7.1 Share Disposals

(i) Companies

(a) Disposal for cash consideration

Capital gains derived from the sale of shares in a local company by either a foreign company or a local company are, in principle, taxable. There is no separate capital gains taxation in Turkey.

Taxation of capital gains derived from the sale of shares between non-residents (individuals or corporations) differs based on the legal status of the company whose shares are held. In case of a joint stock company, the sale of shares between non-residents does not give rise to taxation in Turkey. There is no difference between a majority and a minority sale with respect to tax treatment. Sale of shares in a limited company by non-resident corporations are subject to tax in Turkey through filing of a special tax return. However, foreign exchange gains are not included in the taxable income (except for those derived from continuous trading of securities).

The existence of a bilateral tax treaty between the country of residence of the non-resident shareholder and Turkey may generally result in the avoidance of payment of capital gains tax in Turkey on the condition that the holding period exceeds one year. In general, this is also true for the capital gains arising from the sale of shareholding in a limited company.

In principle, capital gains realised by a tax resident company from a sale are included in the corporate income of the company and are subject to full taxation. However, there is a temporary exemption, which is valid until 31 December 2004 provided that the shares are held for over two years and some other conditions are met. Under the so-called exemption, capital gains derived by tax resident companies from the sale of the subsidiary shares are exempt from corporation tax and VAT if gains are added to the paid-up capital in the year of sale. Please note that Ministry of Finance informally announced recently the possibility of extension of "temporary tax exemption" to further years and even the possibility of making the mechanism permanent by amending the Turkish Corporate Tax Law. Please note that there have not been any formal legislative actions taken in this regard.

(ii) Individuals

Domestic and foreign individuals are not subject to income tax on capital gains arising from the sale of their shares of Turkish tax resident joint stock company, provided that the shares have been held for at least one year (three months for the shares of listed companies). Note that securities other than shares (i.e. participations in limited companies) cannot benefit from this exemption.

If shares of a joint stock company are sold within a year of acquisition, or the participation rights of a limited company are sold regardless of the holding period taxable income is determined after an adjustment for the effects of inflation.

Taxable income is subject to income tax at general rates in the case of individuals. The taxable income is the difference between sale price and inflation adjusted acquisition cost and expenses related to disposal. The Turkish Lira acquisition cost of shares can be adjusted by using the indices announced by the State Institute of Statistics for every month that they have been held, excluding the month of sale. The 12 (twelve) billion (subject to annual adjustment) of gains is exempt from tax. For resident individuals, the tax is paid through submission of an annual tax return. Non-resident individuals are required to file a special tax return and pay the associated tax for capital gains within 15 days following the transaction.

Please note that foreign exchange gains are not included in the taxable income of non-resident individuals (except for those derived from continuous trading of securities).

7.2 Asset Disposals (companies only)

The proceeds of asset transfers are taxable as a part of the commercial income of the selling company. On the other hand, temporary tax exemption mechanism cited in section 7.1 might be utilised for the sale of real estates.

Besides there is another mechanism, namely renewal fund, which is available for deferral of taxation that is only applicable for the assets. Should the renewal of an asset be considered essential based upon the nature of the business or the Board of Directors takes a decision to this effect, any profits stemming from the sale of the assets may be kept under an equity account for a maximum period of three years. This fund will be offset against the depreciation amount of the newly purchased asset and in the event of a balance remaining at the end of the three-year period, it must be transferred to the profit & loss account at that time and will be subject to full corporation tax.

8 Transaction Costs for Sellers

8.1 Share Disposals

(a) VAT

The disposal of shares is exempt from VAT.

(b) Stamp duty

There is no differentiation made for the party liable for tax in the Stamp Tax legislation and both parties of the transaction (i.e. both the seller and the purchaser) are held jointly responsible. Therefore the explanations on stamp tax cited in the section 2.1 are also applicable for the selling party.

8.2 Asset Disposals

(a) VAT

The transfer of assets would be subject to VAT over the sales value of the assets. Therefore an asset disposal would produce VAT that must be calculated in addition to the sales price. VAT exemption is available in cases of tax-free take-overs and de-mergers and for disposals under temporary tax exemption method.

The VAT rate may differ depending on the nature of the assets. The applicable VAT rates are 1%, 8% and 18% currently. Note that the rate of 1% is applied for second hand cars. It is also possible to reduce the VAT rate down to 1%, if the assets are transferred through financial leasing.

(b) Real Estate Transfer Tax

Real estate transfer tax, which is 1.5% on the real estate sale price, is applied separately for acquirer and seller. Thus the seller is also liable to pay the real estate transfer tax, but it could be negotiated with the purchaser to determine who will bear that cost.

(c) Stamp duty

There is no differentiation made for the party liable for tax in the Stamp Tax legislation and both parties of the transaction (i.e. both the seller and the purchaser) are held jointly responsible. Therefore the explanations on stamp tax cited in the section 2.1 are also applicable for the selling party.

9 De-mergers

Although de-mergers have been recognised under tax laws since 2001, detailed regulations of de-mergers under the Corporate Tax and Commercial legislation have only been introduced in mid 2003.

9.1 Types of De-mergers

(a) De-merger as a whole

De-merger as a whole is defined as dissolving without liquidation, whereby all assets, payables and receivables are transferred to two or more resident corporations over their book value, in return for participation shares to be provided to the shareholders of the dissolving entity. Please note that de-merger as a whole is not defined in the Commercial Code yet, thus this type of de-mergers cannot be done at the moment.

(b) Partial De-merger (Spin-Off)

In partial de-merger, the production and service facilities of the companies together with their related tangible and intangible assets, properties and participation shares are transferred to other existing or newly established companies over their book values without liquidation of the former company. The acquiring entity gives its own shares to the de-merged company or its shareholders in return for the above assets, which are contributed as capital in kind to the acquiring company. Note that in order to realize tax-free de-mergers, both the transferor and the transferee companies must be resident in Turkey or must be a non-resident company who operates as a branch office in Turkey.

(c) Share for share (or debentures) exchange

Under the share for share exchange, a resident company acquires the shares of another company in such a way that it obtains a majority of the voting rights in that company in exchange for the shares representing the capital of the former company. Share exchange ratio calculated according to the current value of both the transferring and receiving companies would determine the amount of the shares to be provided to the shareholders of the transferring company.

According to Turkish tax legislation, transactions made under share for share exchange are not subject to taxation. Note that as it is a recently established procedure and it is not defined yet in the Commercial Code, share for share exchange has not been implemented yet.

9.2 Tax Treatment of Transferor Company

(a) Corporate tax

In the case of de-merger as a whole, only the taxable profit derived by the transferor company until the de-merger date will be subject to corporate tax provided that the following conditions are met.

- The corporate tax return including the profit of the de-merged company before the de-merger date must be signed by both parties and submitted to the tax office within 15 days after the

merger date. The balance sheet and income statement of the transferor company must also be submitted as an attachment to the tax return.

- The transferee company must declare to the tax office that the transferee company itself undertakes all taxes that have been or will be accrued and other liabilities of the transferor company.

(b) VAT

No VAT will be calculated over transfer of assets in de-mergers.

(c) Other Transaction Taxes

De-merger transactions are exempt from any transaction taxes and fees, including stamp tax and Banking and Insurance Transactions Tax..

9.3 Tax Treatment of Transferee Company

If realised according to the provisions of Corporate Tax Law, de-merger transactions are exempt from any transaction taxes and fees.

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