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Doing Business in Turkey in a nutshell



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1. Turkish Market Overview



Driven by private consumption and supported by a stable macroeconomic policy framework, the Turkish economy has grown significantly since the country emerged from the 2001 financial crisis. Between 2002 and 2007 Turkey's GDP experienced an annual average growth of 7%, versus 2.8% in the EU. In the same period, Turkey's GDP has increased to US\$660bn, making it the 17th largest economy in the world.

Restructuring of the banking sector, monetary discipline based on independence of the Central Bank and a floating exchange rate regime, tight fiscal policy, public administration reform, and the EU accession process with reform packages enacted by the Parliament all contributed to the transformation of the country after the 2001 crisis.

The results since then have been impressive. Turkey has attracted c. US\$52bn FDI in the last three years, increasing its FDI inflow ranking from 53rd in 2003 to 37th place in 2004, 22nd place in 2005 and 16th place in 2006.

Between 2005 and 2007 the Privatisation Administration concluded US\$20.5bn worth of transactions. The figure includes US\$6.55bn committed by Saudi Oger for 55% of Turk Telekom in 2005, US\$6.91bn put up by local groups for controlling stakes in refiner Tupras and steel mill Erdemir in 2005-06, and US\$755mn paid by PSA of Singapore and partners for Mersin port management rights in 2007. The completion of a US\$1.28bn deal for Izmir port involving Hutchison Whampoa of Hong Kong is imminent. In addition, mobile phone operator Telsim was sold to Vodafone for US\$4.55bn by the Savings Deposit Insurance Fund.

In 2008 the following sums were obtained from privatisations; state petrochemicals company Petkim, US\$2.04bn; state tobacco monopoly Tekel, US\$1.72bn; Baskent electricity distribution company, US\$1.23bn; and Sakarya electricity distribution, US\$600mn.

1.1. Key Attractions of Turkey

- Turkey is located at a close proximity to Europe (two-three hours' flight to major European destinations), The Middle East and the Caucasus. Turkey benefits from its location as a bridge between Europe and Asia. It also acts as an energy corridor connecting these two continents.
- Turkey entered a customs union with the EU in 1996 and has been an EU accession country since 2005. This has resulted in the expansion of trade relations with Europe, which now accounts for 47% of Turkey's foreign trade.
- Turkey offers an accessible, skilled and cost-effective workforce, providing the fourth largest labour force amongst the EU members and accession countries. It boasts a large population of over 70 million people, with an average age of 29.

- The Turkish government provides various tax and non-tax incentives to foreign investors, in line with those provided to domestic companies. These include customs and VAT exemptions on various imported or locally delivered goods, including machinery and equipment, as well as priority regions offering incentives such as free land and energy support. Investors are also able to benefit from R&D support and market research with the aim of encouraging exports and increasing the competitiveness of firms in international markets.
- The Turkish government has also introduced flexible exchange rate policies and liberal import regulations in order to promote and sustain foreign investment.
- In recent years Turkish banks have taken an increasingly large role in financing project finance deals, benefiting in many cases from increasingly liquid balance sheets. This year, BC Partners raised US\$750mn from Turkish financial institutions (to finance the acquisition of the Migros Türk supermarket chain) and TAV raised US\$500mn for acquisitions. In 2007 KKR raised US\$550mn to finance its UN Ro-Ro acquisition, and Abraaj Capital raised US\$200mn to finance its Acibadem Hospitals acquisition.
- The Turkish legal framework offers a level playing field to foreign investors and domestic companies. Foreign ownership is unrestricted, with no pre-entry screening requirements.
- A new commercial code is currently with the General Assembly of the Parliament for approval. The Code aims to integrate the Turkish Commercial Code with EU law, improve transparency, protect minority rights and strengthen corporate governance principles.

1.2. Challenges are Important

- While Turkey does not have a subprime mortgage issue, like other emerging markets, it is affected by the ongoing global credit turmoil (i.e. increasing CPI due to rising oil and food prices). At present the Turkish Central Bank's prime lending rate is 15.75%, compared with 13.25% in April 2006.
- Political instability in Turkey's neighbouring countries poses a potential threat of conflict within the region. However, this affects primarily south-eastern Turkey, whereas the industrial base is concentrated in the west.
- There is a split between the east and the west of the country; economic development, investment opportunities, infrastructure and skilled staff are concentrated in the west.
- Although Turkey is moving towards adopting International Financial Reporting Standards (IFRS), this is still a work in progress. In practice accounting standards will vary from company to company.
- Turkey suffers from rising energy prices. Up to 90% of its oil and 97% of its gas resources are imported from Russia and the Middle East.
- The country's current account deficit is large. In recent years it has been comfortably financed by foreign direct investment, but long term it could lead (as it has in the past) to inflation and currency instability.
- In spite of interest rates' swiftly shrinking down to record low levels, they are still high in comparison to most European countries.

1.3. Key Industries in Turkey

- Between 2002 and 2007 the Turkish construction sector experienced a significant compound annual growth of 11%, higher than Turkey's GDP growth in the same period. This growth rate is expected to reduce in the following years; however sector growth still exceeds GDP growth as a whole. Key drivers include increased housing needs, eased housing credits allowing people to upgrade their homes, an increase in the number of large-scale Turkish contracting firms, and the growth of the building materials sector. Turkey is currently a market leader in terms of cement exports and is ranked 11th in the world for unprocessed steel production.
- The automotive industry is very important. At present Turkey is the largest producer of buses in Europe. It is also responsible for more than 7% of Europe's motor vehicle production. Turkey anticipates becoming the third largest producer of motor vehicles in Europe by 2015. Ford, Toyota, Renault, Hyundai, Fiat, Honda, Mercedes, MAN and Isuzu have manufacturing plants in Turkey.
- At present Turkey's energy and utilities sector is attracting significant interest from foreign investors, following the recent split of Turkey's main energy provider into many regional companies. The government intends to privatise these companies, providing significant opportunity for investment, however there is some public opposition. Privatisation tenders for state-owned electricity distribution companies recently commenced in two regions.
- New government legislation introduced to support the development of renewable energy is making foreign investment in that sector more attractive. The aim is that it will provide feed-in tariffs for electricity provided by renewable energy sources. In November 2007, licence applications equal to Turkey's current established power capacity were submitted to the Energy Market Regulatory Authority (EMRA).
- Since Transportation and Logistics is one of the main pillars of both national and international trade, the Turkish government is making ongoing investments to create a new infrastructure. At a conference in London in October 2007 the Turkish prime minister announced plans to open up railways, roads, metro projects, public housing and airports to foreign investment, which should provide additional opportunities. Studies for bridge and motorway privatisations have begun and are envisaged to be completed in 2009.
- Despite the uncertainties of being in a transition period, the Turkish healthcare sector offers great opportunities for the private sector, which is forecast to be a significant contributor of growth going forward. The healthcare sector expects double digit growth of around 10% between 2007 and 2011.
- The restructuring of the Turkish banking sector, initiated after the 2001 financial crisis, has had a positive impact on the stability of the system, making it more conducive to rapid growth and the franchise building process. Total assets grew by 22% CAGR between 2002 and 2007, reaching US\$500bn. Attractive potential and consistent high growth resulted in the significant interest from foreign investors in the Turkish banking sector by, for example, Citibank, UniCredito, GE Consumer Finance, Dexia, National Bank of Greece, BNP Paribas, Eurobank, etc.

2. Legal Environment: Specificities

2.1. Company Structures and Establishment Procedures

The Turkish Commercial Code provides several company structures in Turkey: joint stock companies, limited liability companies, collective companies, partnerships limited by shares and co-operative associations. The legal differences between those company structures mainly concern the allocation of liability and the legal form of the entity.

Since 2003 foreign investment has been regulated in a more liberalised manner under Foreign Direct Investment Law, No. 4875. Under this law foreign investors may freely start up businesses in company, branch office or liaison office forms. However, largely due to the favourable position concerning the liabilities borne by shareholders, joint stock companies and limited liability companies are the corporate structures in Turkey most commonly chosen by foreign investors, along with the other business setup forms of branch offices and liaison offices. These companies and business setup forms may serve different business purposes and are compared in Appendix I.



Law No. 4875 has significantly simplified the establishment process for all business forms. The incorporation process of these types of companies are simple procedures and normally do not take more than four weeks. Companies established by foreign shareholders are entitled to all the rights available to Turkish companies under the Turkish Commercial Code.

2.2. New Turkish Commercial Code

The Draft Turkish Commercial Code is currently with the General Assembly of the Parliament for approval and is expected to enter into force by the end of 2008. It will redefine some important aspects of corporate life. Among these reforms it will enable the incorporation of a joint stock company (A.Ş.) and the limited liability company (Ltd.) with a single shareholder or partner, respectively. It will also, for the first time in Turkey, cover group companies, i.e. the relations between the parent company and subsidiaries which are subject to the same principles and policies and are gathered under the same group management. In order to ensure transparency, each capital company has to have an internet site and if such a site is already available, to render a certain part of it specific for information to stakeholders. Joint stock companies will be allowed to hold online general assembly meetings. All administrative transactions of joint stock companies may be conducted online, which will create such options as online attendance for general assembly meetings, online submission of motions, online negotiations and online voting.

2.3. New Code of Obligations

The Turkish Code of Obligations is also being harmonised with EU law and at the moment a new draft code is with a parliamentary commission pending approval. Its innovations include arrangements regarding the "pre-emption right" and a new provision under the heading of "Formation of Contract", which has been added to the First Division of Section 1, "Sources of Debt Relations", in the "General Provisions" of the draft bill - Article 7, "Dispatch of Unordered Goods". The "Written Form" requirement is made compliant with the Electronic Signature Law, No. 5070. The "participation in debt" by the third persons in Article 206, and the "transfer of contract" in tenders or similar other situations in Article 210 and the "joining in contract" on the side of either party thereto in Article 211 are new provisions which are not dealt with in the current Code of Obligations.

2.4. Competition Law

The Turkish Competition Law, No. 4054, is envisaged to undergo significant changes, despite its being a relatively young law, published in December 1994 and amended in July 2005. The proposed amendments aim to either facilitate or clarify the implementations of some provisions of the Competition Law. The draft amendment includes changes to merger control rules, powers of the Competition Board, exemption rules, the Board's right to ask for information, sight inspections, monetary fines and investigations.

2.5. Draft Turkish Maritime Regulation in the Draft Commercial Code

The Draft keeps seven sections (Ship, Shipowner, Shipping Enterprise, Master, Contracts for Maritime Commerce, Maritime Accidents, Maritime Liens) in the same order as in the Maritime Book of the Turkish Commercial Code, and adds a new section: Special Provisions on Compulsory Maritime Execution. To facilitate the introduction of

fundamental changes, the Commission chose to reorder the articles in the draft, a change that produced a new difficulty: recalling the new order of articles in the draft by those accustomed to the order in the 50 year old Maritime Book.

2.6. Turkish Labour Law

The Turkish Labour Code, Law No. 4857, regulates the employer-employee relationship in Turkey as individual parties. It regulates the conditions of the employment contract for which legal requirements are to be evidenced in writing if they are to be signed for a definite period of one year or longer. It also regulates the probationary period which shall be at most one month for employment contracts signed for a permanent period. During this period, the parties may terminate the employment contract without notice and compensation. The salary shall be paid to the employee once a month and a commission working under the Ministry of Labour and Social Security determines the minimum monthly gross wage to constitute a fair income level for the employees by taking into account the cost of living. As regards the termination of the employment contract, these may either be concluded for a definite or indefinite period of time, in the latter case both the employee and the employer are entitled to terminate the contract by observing the minimum periods stated in the Turkish Labour Code.



3. Tax Environment: Specificities

The new Corporate Income Tax Law, No. 5520, replaced the former Corporate Income Tax Law as of 1 January 2006. The new law introduces extensive amendments, including formerly ambiguous issues such as transfer pricing and thin capitalisation in line with OECD guidelines and worldwide applications, together with defining new provisions such as controlled foreign company applications and anti-tax haven regulations.

Likewise, currently a new Income Tax Law is being prepared that is expected to bring about significant changes in line with contemporary international tax practices.

3.1. Tax Residency

According to Turkish tax legislation, income taxation differs significantly based on where the taxpayer is resident.

If both the legal and the business headquarters of a company are located outside Turkey, the company is regarded as a non-resident entity. If one of these headquarters is located within Turkey, the company is regarded as a resident entity. Resident entities are subject to tax on their worldwide income, whereas non-resident entities are taxed solely on the income derived from activities in Turkey

3.2. Corporate Tax System

Corporations are liable to taxation as described below:

Profits generated, as adjusted for exemptions and deductions, including prior-year losses carried forward, are liable to corporation tax at 20%.

Dividend distributions to individual and non-resident corporate shareholders are subject to withholding tax at the rate of 15%. This rate might be reduced in the existence of a tax treaty. Please note that dividend distributions to resident entities and branches of non-resident entities are not subject to dividend withholding tax. Corporations are required to pay advance corporation tax based on their quarterly balance sheets and income statements at the rate of 20%. Advance corporation tax paid during the year is offset against the corporate tax liability calculated over the annual corporate tax return. The balance of advance tax can be refunded or used to offset other tax liabilities.

Turkish Corporate Income Tax Legislation allows as a deduction of "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business". The general principle for tax deductibility is that payment



should be a necessary business expense and it should be properly documented in accordance with the relevant provisions of Tax Procedure Law. In cases of charges from related parties, arm's length pricing is also sought.

Corporate losses may be carried forward for five years, but losses may not be carried back.

3.3. Major Transaction Taxes

There are various transaction taxes in Turkey, as is the case in OECD member countries

VAT

Deliveries of goods and services are subject to VAT at rates varying from 1% to 18%. The general rate applied 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. If output VAT is in excess of input VAT, the excess amount is paid to the related tax office. Conversely, if input VAT exceeds output VAT, the balance is carried forward to the following months to be offset against future output VAT. With the exception of a few situations, such as exportation and sales to an investment incentive holder, there is no cash refund to recover excess input VAT.

There is also a so-called “reverse charge VAT mechanism”, which requires the calculation of VAT by resident companies on payments to foreign countries. Under this mechanism, VAT is calculated and paid to the related tax office by the Turkish 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 for the former, if there is no sufficient output VAT to offset there from.

Special Consumption Tax

There are four main 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, this tax is charged only once.

Banking and Insurance Transactions Tax (BITT)

Banks and insurance companies are exempt from VAT but are subject to BITT at a rate of 5%, which is due on the gains of such companies from their transactions. The purchase of goods and services by banks and insurance companies are subject to VAT but this is considered as an expense or cost for recovery purposes.

Property Taxes

Buildings and land owned in Turkey are subject to real estate tax at different rates.

Stamp Tax

Stamp tax applies to a wide range of documents, including but not limited to agreements, financial statements and payrolls. Stamp tax is levied as a percentage of the monetary value stated on the agreements at rates ranging from 0.15% to 0.75%. Please note that salary payments are subject to stamp duty at the rate of 0.6% over the gross amounts paid, whereas a lump sum stamp tax is calculated for financial statements.

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. Companies in Turkey are responsible for withholding such taxes on their payments and declaring them through their withholding tax returns. However, please note that local withholding tax rates may be reduced based on the available bilateral tax treaty provisions.

3.4. Related Party Transactions

In principle, transactions between the related parties must be carried out on an arm's length basis. There are specific rules in this respect in Turkish tax legislation, as stated below.

Thin Capitalisation

According to the thin capitalisation regulation, if the ratio of the borrowings from shareholders or from persons related to the shareholders exceeds triple the shareholders' equity of the borrower company at any time within the relevant year, the exceeding portion of the borrowing will be considered as thin capital. Accordingly, under the new thin capitalisation regulation, the ratio of the loans received from related parties to shareholders' equity will be considered as three to one. Excluding loans received from credit institutions that provide loans only to related companies, half of the loans received from related banks and similar institutions are to be taken into account during thin capitalisation calculations. In other words, the loans received from these institutions alone will not be considered thin capital until the amount of the borrowing exceeds six times the shareholders' equity.

In addition to the interest paid or accrued, foreign exchange losses and other similar expenses calculated over the loans that are considered as thin capital are treated as non-deductible for corporate income tax purposes. The interest paid or accrued and similar payments on thin capital are reclassified at the end of the relevant fiscal year as dividend distributed from the perspective of the borrower and as dividend received from the perspective of the lender, and as repatriated profit for non-resident taxpayers.

Transfer Pricing

With the new Corporate Income Tax Law, considerable amendments are made to transfer pricing regulations, taking OECD transfer pricing guideline as a basis. If a taxpayer enters into transactions regarding sale or purchase of goods and services with related parties, where the prices are not set in accordance with the arm's length principle, then related profits are considered to be distributed in a disguised manner through transfer pricing. Such disguised profit distributions through transfer pricing are not accepted as tax deductible for corporate income tax purposes. Prescribed methods in the law are the traditional transactions methods described in the OECD transfer pricing guideline.

Anti-Tax Haven Provisions

All sorts of payments made to corporations (including branches of resident corporations) that are established or operational in countries which are regarded by the Council of Ministers to undermine fair tax competition due to tax and other practices will be subject to taxation in Turkey irrespective of whether the payments in question are subject to tax or not, or the corporation receiving the payment is a taxpayer or not.

In this case, withholding tax at the rate of 30% is envisaged to be levied over these payments. However, this will not be applied in some cases.

Treatment of Group Companies

Consolidation of the accounts of group companies for tax purposes is not allowed in Turkey since each company is regarded as a separate taxpayer.

Controlled Foreign Corporation Rules

Corporations established abroad and controlled directly or indirectly by 50% or more by tax resident companies and real persons by means of separate or joint participation in the capital or dividends or voting rights are considered to be CFCs, provided certain conditions are fulfilled i.e. 25% or more of the gross revenue must be composed of passive income, the CFC must be subject to an effective income tax rate lower than 10% for its commercial profit in its home country, etc. The CFC's profit would be included in the corporate income tax base of the controlling resident corporation at the rate of the shares controlled, irrespective of whether it is distributed or not, in the fiscal period covering the month of closing of the according of CFC.

3.5. Holding Regime in Turkey

There is an unconditional corporate tax and dividend withholding tax exemption for dividend income between Turkish companies. If a Turkish company has a shareholding in a foreign company this dividend income is exempt from corporate tax under certain conditions.

For capital gains generated from share sale in a Turkish company by another Turkish company, 75% corporate tax exemption is applicable under certain conditions. In the event a foreign subsidiary is sold by a Turkish company, under certain conditions 100% corporate tax exemption is applicable.

Appendix I - The Main Characteristics of Most Common Companies and Business Setup Forms in Turkey

Corporations/ Characteristics	Joint Stock Company	Limited Liability Company	Branch Office	Liaison Office
Number of Shareholders	Minimum 5, maximum number not determined.	Minimum 2, maximum 50.	N/A	N/A
Capital	Minimum Capital: TRY 50,000.	Minimum Capital: TRY 5,000.	The parent company has to allocate capital to the branch office during establishment phase. There is no minimum capital amount regulated.	N/A
Field of Activity	Any kind of economic activity to fulfil its main investment purpose provided that it is not prohibited by law and limited with its articles of association.	Any kind of economic activity provided that it is not prohibited by law and limited with its articles of association. Prohibited to operate in banking and insurance sector and several other sectors.	The branch offices do not have any separate AoA and conduct their activities as to the provisions of the AoA of its parent company.	Prohibited to display any commercial activities. The main activities of the liaison offices may be market research and survey on subsidiary in Turkey.
Statutory Organs	General Assembly of Shareholders: The ultimate decision making organ. Comprises all shareholders. The Shareholders Assembly shall convene ordinarily at least once a year. It may also convene extraordinarily. Board of Directors: It is composed of at least 3 (three) members and elected among the individual shareholders or the individuals who represent legal entity shareholder. Auditors: 1 (one) at min. 5 (five) at max.	Partners Assembly: The decision making organ mostly in respect of the internal affairs of the company. The ordinary partners assembly meetings with more than 20 partners must convene at least once a year. Directors: Unless agreed otherwise, the founding partners are the directors of the company. No min. or max. number is indicated under TCC. Auditors: Required only for companies with more than 20 partners.	At minimum a Turkish national representative shall be assigned and authorised with Power of Attorney by the parent Company. A representative shall be assigned and authorized with Power of Attorney by the parent Company.	The liability of the shareholders exists only against the company and is limited with the payment of the subscribed share capital. It is not possible to recourse to the shareholders for any liability of the company.
Liabilities of Shareholders/ Partners	The liability of the shareholders exists only against the company and is limited with the payment of the subscribed share capital. It is not possible to recourse to the shareholders for any liability of the company.	The liability of the shareholders exists for the payment of the subscribed share capital. Recourse to the shareholders for public debts in proportion to their shareholding in the company (Article 35, Law Concerning the Collection of Public Receivables) may be possible if the company is not able to pay its public debts.	Parent company of the branch office shall be liable for the activities of the branch office.	Parent company of the liaison office shall be liable for the activities of the liaison office.

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