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# *A vision of Turkey for the Italian Investor*

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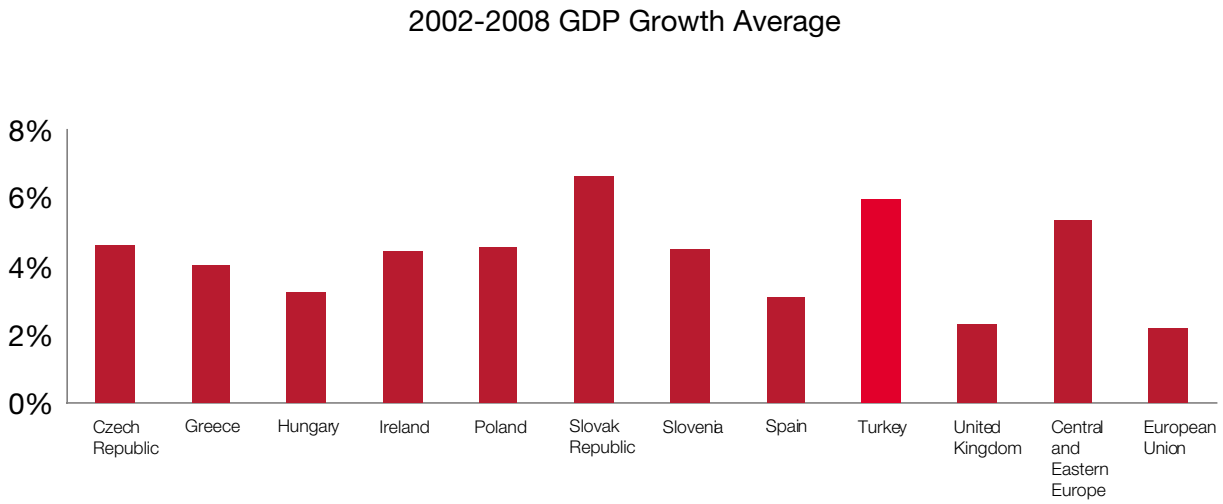
# *Turkish Market Overview*

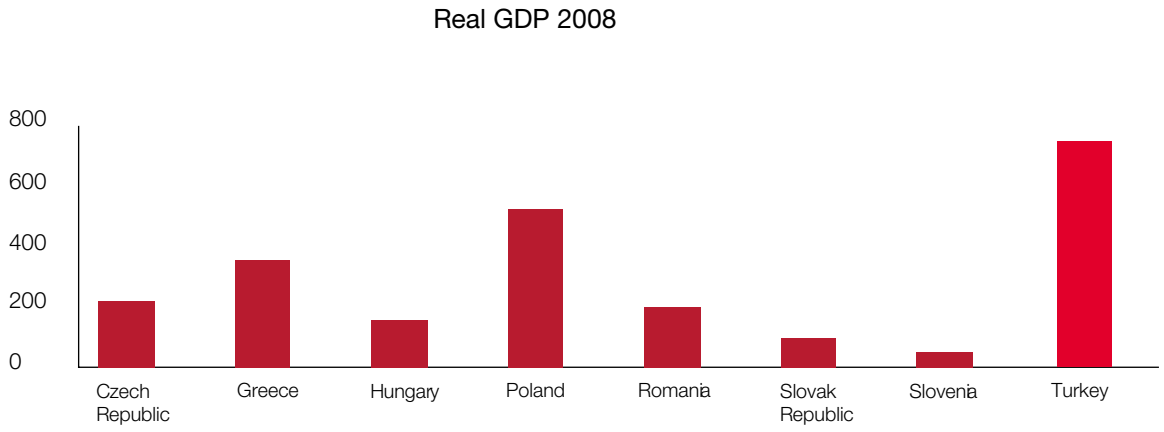
## Strong Economic Growth

Driven by private consumption and supported by a stable macroeconomic policy framework, the Turkish economy has grown significantly within the last decade. Between 2002 and 2008 Turkey's GDP (Gross Domestic Product) experienced an annual average growth rate of 6%, versus 2.2% in the European Union (EU). In the same period, Turkey's GDP has increased to US$741bn, making it the 17th largest economy in the world and one of the world's ten "Big Emerging Markets".

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




**Source:** World Economic Outlook (April 2009)

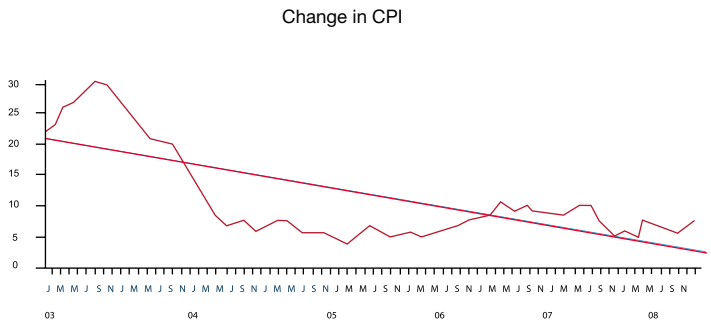



**Source:** World Economic Outlook (April 2009)

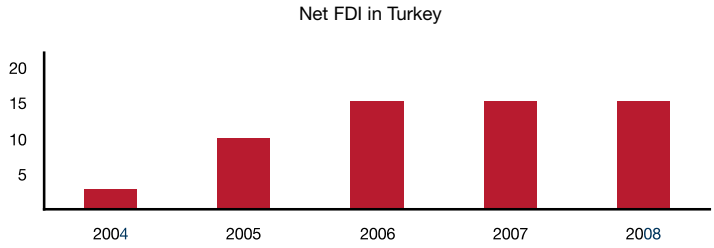
# 02

## Impressive Disinflation

One of the most striking aspects of the recent performance of the Turkish economy has been the substantial decline in the inflation rate in a strong growth environment with soaring energy prices. In fact, the year-on-year change in the CPI (Consumer Price Index) of 25.5% in 2003 decreased to 5.3% in 2009.




**Source:** Central Bank of Turkey




**Source:** www.yased.org.tr

The implementation of tight fiscal and strict monetary policies have helped to decrease inflation significantly. Turkey has been able to attract a significant level of foreign direct investment (FDI) in recent years because the stability of the economy was able to enhance the investment environment.

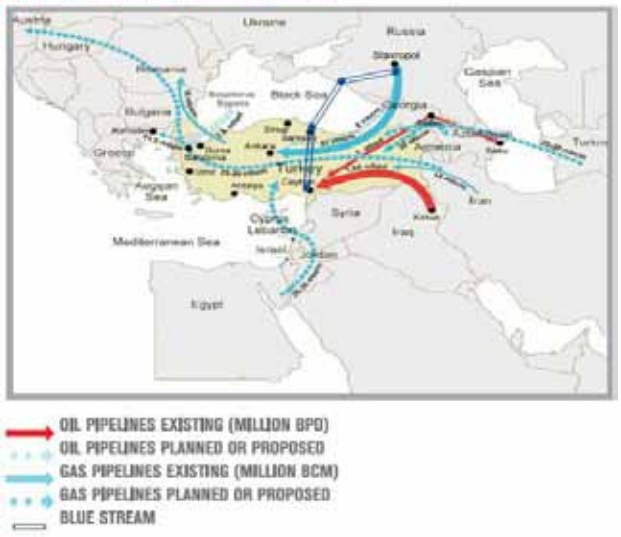
The results since then have been impressive.
Turkey has attracted circa US$73.2bn FDI between 2004 and 2008, increasing its global FDI inflow ranking from 37th place in 2004 to 23rd in 2008. In 2008, 66% of total FDI inflows (total FDI in 2008 : US$ 18bn) were placed in the services sector, with the remaining targeted to industrial sectors, among which food-beverages-tobacco, chemicals and basic metals have been the hot investment areas in particular.

Privatizations have been an important source of investment. In fact, between 2005 and 2008 the Privatisation Administration of Turkey signed US$206.58bn worth of transactions.
The proceedings from the privatization of electricity distribution and generation, together with natural gas distribution assets are expected to be cashed in as of 2010 implying better results going forward.

## Key Attractions of Turkey

- Turkey is located in close proximity to Europe, the Middle East and the Caucasus. It's location is also advantageous bridging the Europe and Asia transportation route and serves as an energy corridor connecting these two continents. The largest part of the Baku-Tbilisi-Ceyhan Crude Oil Pipeline snakes through Turkey while the construction of the Nabucco Natural Gas Pipeline, both carrying the Caspian hydrocarbon resources to the rest of world, suggest the benefits from Turkey's geographical location.

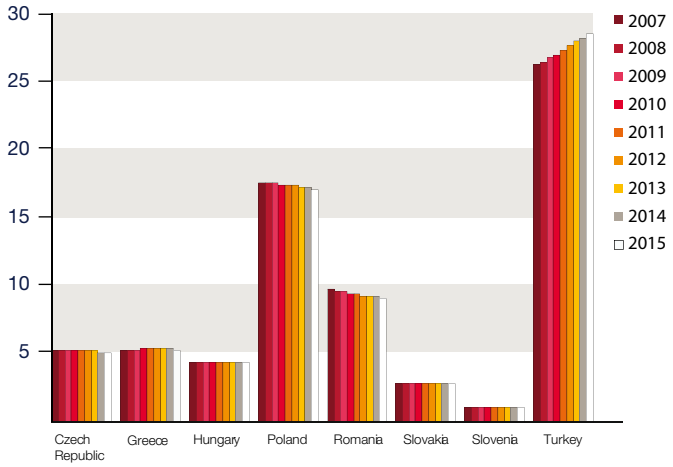
## Pipeline transportation projects




**Source:** www.invest.gov.tr

- Turkey joined the Customs Union agreement 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 accounts for 47% of Turkey's foreign trade as of 2008.
- Turkey offers an accessible, skilled and cost-effective workforce, providing the fourth largest labour force amongst the EU members and accession countries. A large population of over 70 million people, with an average age of 29, is an important contributor to the labour force growth and has helped Turkey rank highest among its competitors. The projections by the International Labor Organisation (ILO) underline the steady growth in the labour force in Turkey until 2015, whereas no significant change is assumed for its peer countries in Central and Eastern Europe.
- The strength of its labour force is reflected in Turkey's high productivity and low absenteeism rates together with its position as one of the countries with the highest annual working hour rates. In addition, labour costs in Turkey are very competitive.
- Turkey has one of the most competitive corporate tax rates in the OECD (Organisation for Economic Cooperation and Development) region. Various tax and nontax incentives are available for both foreign and domestic investors.

## Labor Force




These include customs and VAT exemptions on various imported or locally delivered goods, including machinery and equipment, and also free land use and energy cost subsidies in the region subject to developmental priority regulations. Investors can also benefit from R&D support and market research provided with a view to maximize the aim of encouraging exports and boost the competitiveness of firms in international markets.

- Flexible exchange rate policies and liberal import regulations are also in place to promote and sustain foreign investment.
- In recent years Turkish banks have taken an increasingly large role in project financing, increasingly liquid balance sheets.
- The Turkish legal framework offers a level playing field for foreign investors and domestic companies. Foreign ownership is unrestricted, with no pre-entry screening requirements.
- The draft of the new Turkish Commercial Code is currently under Parliamentary consideration.This draft code aims to integrate the Turkish commercial regulation with the acquis communautaire of the EU, improve transparency, protect minority rights and strengthen corporate governance principles.

## Challenges are Important

- Despite having no direct exposure to the sub prime mortgage crisis, unlike other emerging markets, Turkey is still affected by the other aspects of the ongoing global credit turmoil resulting in a slowdown of its GDP growth.
- Despite gradual deceleration, interest rates are still high compared with the European average.
- Political instability in Turkey's southern and eastern neighbouring countries pose a potential threat of conflict within the region. Nevertheless, the concentration of the Turkish industrial base including investment opportunities, infrastructure and skilled staff, is distant from these affected areas, mitigating any political risk that may be present.

# 04

## Key Industries in Turkey

- Between 2002 and 2007 the Turkish **construction** sector experienced a significant compound annual growth of 11%, which was higher than Turkey's GDP growth rate for the same period. Although a construction slowdown is not a remote possibility its growth rate is still expected to exceed Turkey's GDP growth rate. Turkey is currently a market leader in cement export and is ranked 11th in the world for unprocessed steel production.
- The **automotive** industry is very important, in that Turkey is the largest bus manufacturer in Europe, and holds a 7% share in motor vehicle manufacturing. The fact that Ford, Toyota, Renault, Hyundai, Fiat, Honda, Mercedes, MAN and Isuzu all have manufacturing plants in Turkey, and the country anticipates becoming the third largest producer of motor vehicles in Europe by 2015.
- At present Turkey's **energy and utilities** sector is attracting significant interest from foreign investors. The ongoing privatizations of the distribution assets in the utilities sector constitute an important inroad for the FDI, in that, the international players have been among the winners of the big ticket tenders. The ongoing momentum in privatizations is to attract more room for foreign involvement in these strategic markets, following the split of the state electricity distribution company into 21 regional companies. The government intends to privatise these companies, providing significant opportunity for investment.
- The electricity demand in Turkey displayed a spectacular yearly average growth of 6% between 2000 and 2008, and already attracted a plausible amount of foreign investors.

- The resilience in demand implies a looming supply bottleneck in a couple of years and therefore urges the Turkish government to provide a favourable investment environment in electricity generation capacity.The ongoing debates in the Turkish Parliament to improve the incentives for the use of renewable resources for electricity generation are promising. The draft legislation with the aim to support the development of renewable energy with a more effectiveincentive mechanism is making foreign investment in that sector more attractive.
- Since **transportation and logistics** are among one of the main pillars of both national and international trade, the Turkish government is making ongoing investments to enhance infrastructure. Plans to involve foreign parties in building railways, highways, underground projects, public housing and airports have been already announced, in such a way as to provide additional opportunities. Feasibility studies for bridge and motorway privatisations are already underway and envisaged to be completed over the next couple of years.
- The Turkish **healthcare** sector, a significant contributor to growth going forward, offers great opportunities for the private sector. In fact the healthcare sector is expected to enjoy double digit growth of ca.10% between 2007 and 2011.
- The restructuring of the Turkish **banking** sector, initiated after the 2001 crisis, has had a positive impact on the stability of the system, making it more conducive to rapid growth and the franchise building process. In fact, total assets in the sector grew by a 22% CAGR (compounded annual growth rate) between 2002 and 2007, reaching US$500bn.
- Attractive potential and consistent high growth resulted in a significant interest from foreign investors in the Turkish banking sector, for example, by Citibank, UniCredit, GE Consumer Finance, Dexia, National Bank of Greece, BNP Paribas, Eurobank, etc.

# *Legal Environment: Specifics*

## Company Establishment Procedures

Since 2003 foreign investment has been regulated in a more liberalised manner under Foreign Direct Investment Law. 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. This law 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 the same rights that are available to Turkish companies under the Turkish Commercial Code.

## New Turkish Commercial Code

The Draft Turkish Commercial Code is currently with the General Assembly of the Parliament for approval and will redefine some important aspects of corporate life.

The objectives of the new law are:

- Integration of commercial code with EU law
- Fair competition
- Infrastructure for transparency and information society
- Corporate Governance principles
- Generally accepted accounting and audit standards
- Democracy among shareholders
- Use of information technology tools

## Turkish Labour Law

The Turkish Labour Code regulates the employer-employee relationships 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 two months 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 contracts, 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.

# *Tax Environment: Specifics*

The new Corporate Income Tax Law 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 (Organisation for Economic Cooperation and Development) guidelines and worldwide applications, together with defining new provisions such as controlled foreign company applications and anti-tax heaven 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.

## Tax Residency

According to the 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.

## Corporate Tax System

Profits generated, as adjusted for exemptions and deductions, including prior-year losses carried forward, are subject to corporation tax of 20%. Dividend distributions to individual and non-resident corporate shareholders are subject to withholding tax at the rate of 15%. This rate may be reduced with 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 Procedural 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.

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# Contacts

## Our Services

Audit and Assurance
Tax & Legal
Transaction Services
Performance Improvement

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