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TAX

Part 1: The Double Tax Treaty Signed Between Turkey and Gambia

The Convention between the Government of Gambia and the Government of the Republic of Turkey for the Avoidance of Double Taxation with respect to the Taxes on Income and the Prevention of Fiscal Evasion has been signed in Ankara on February 11, 2014. The convention will be effective upon the ratification of the parliaments of both States and the completion of all necessary procedures. Upon the signing of this convention, the number of double tax treaties signed by Turkey has reached 84 and 80 of those have become effective.

Part 2: More Moderate Criteria for Auditing Requirement

As it was stated in our Legal Alert: Tax 2013/1, the criteria for being subject to independent audit was determined under the Decree of the Council of Ministers No.2012/4213. However, new criteria were introduced by the Decree of the Council of Ministers No. 2014/5973 (*published in the Official Gazette dated March 14, 2014 and No.28491*) which lowers the previous ones. In this regard, the new regulation increases the number of corporations subject to independent audit. According to the Decree No. 2012/4213, companies which meet two (2) of the respective criteria in two successive fiscal periods shall be subject to an independent audit. The old and the new criteria are comparatively shown in the chart below:

The Old Criteria Stated under the Decree No.2012/4213	The New Criteria Stated Under the Decree No. 2014/5973
Corporations with total assets of at least TL 150.000.000	Corporations with total assets of at least TL 75.000.000
Corporations with net sales revenue at least TL 200.000.000	Corporations with net sales revenue of at least TL 150.000.000
Corporations with at least 500 employees	Corporations with at least 250 employees

According to Article 4/6 of the Decree No.2012/4213, the Public Oversight Accounting and Auditing Standards Authority (the "**Authority**") has been authorized to regulate the procedures and principles in relation to the application of the Decree No.2012/4213. In accordance with such authority, the Procedures and Principles in relation to the application of the Decree No.2012/4213 (the "**Procedures and Principles**") has been published in the Official Gazette dated March 12, 2013 and No. 28585 by the Authority, and pursuant to Article 14 of the Procedures and Principles, it is effective as of 1.1.2013. It is also stated under temporary article 1 of the Procedures and Principles

that the corporations having special accounting period shall take into account their accounting periods ending in the year of 2012 and 2013 in order to determine whether they are subject to independent audit for the financial year starting in 2013 and ending in 2014. Based on this, the corporations having special accounting period were not subject to independent audit for the financial year starting in 2012 and ending in 2013. Therefore, both the Decree No.2012/4213 and the Procedures and Principles were applied for the accounting periods starting from the effective date of 1.1.2013 of the Decree No.2012/4213 and the Procedures and Principles.

The effective date of the Decree No. 2014/5973 is 1.1.2014, and there is no explanation in the Decree No. 2014/5973 on whether the corporations having a special accounting period shall be subject to independent audit for the current financial year, starting in 2013 and ending in 2014. In the first instance, considering that the Decree No. 2014/5973 is effective as of 1.1.2014, the corporations having a special accounting period shall be subject to independent audit for the current year. However, parallel to the application of the Decree No.2012/4213, the independent audit criterion shall be considered for the financial years starting in 2014.

Accordingly, the Decree No. 2014/5973, having the effective date of 1.1.2014, shall be applied for the accounting periods starting from 1.1.2014 which means the criterion shall be considered for the financial year starting in 2014 and ending in 2015 by the corporations having a special accounting period. Therefore, the corporations having special accounting periods shall not be subject to independent audit for the accounting year starting in 2013 and ending in 2014 providing that they do not meet the criterion stated in the Decree No.2012/4213.

The new criterion will be effective for the financial year of 2014 for the corporations of which the accounting period is the calendar year. Therefore, the corporations which meet the new criterion in 2012 and 2013 shall be subject to independent audit for the financial year of 2014.

Part 3: New Interpretation of Tax Authority regarding the Taxation of the Investments with Build-Operate-Transfer Model

The Tax Authority, in its ruling dated August 07, 2013 and No.62030549-120[94-2013/391]-1213, changed its interpretation with regard to the taxation of the investments conducted with Build-Operate-Transfer ("**BOT**"). As it is known, in BOT, lessee makes his investment on the land owned by the counter party ("**Land Owner**") to the BOT agreement. Land owner does transfer, for a definite time, the right of utilization of the land on which the investment will be made. In return for the transfer of utilization right of the land, Land Owner does not collect any fees in the lease term but, the investment will be transferred to the land owner at the end of the lease term free of charge. The Tax Authority previously determined the taxation of the BOT as follows;

1. Lessee capitalizes the cost of the building constructed on the leased land as a leasehold improvement. Since no actual transfer or payment is conducted during the lease term, the Lessee does not issue any invoice to the Land Owner and does not calculate any VAT.
2. Lessee writes off the leasehold improvements through amortization during the lease period.
3. At the end of the lease agreement, lessees transfer the building to the Land Owner in return for the free use of the land. However, this transfer is deemed to be done over its fair market value corresponding to the total lease amount, and the transfer shall be subject to VAT over the fair market value.
4. In addition, if the land owner is an individual, the transfer shall be subject to 20% withholding tax. The Land Owner shall also declare his income collected as in kind to the tax authority and pay his income tax.

However, the Tax Authority changed its abovementioned interpretation with the above stated tax ruling. According to the new interpretation of the Tax Authority;

1. Lessee shall add a profit margin, determined through arm's length principle, to the cost of the building and shall invoice the whole amount (the construction expenses + the profit margin) plus VAT to the Land Owner on the date in which lessee starts to use the building. Therefore, lessee does not book the cost of the building as leasehold improvements and does not amortize it. The profit added to the cost of the building construction is included in the income tax base of the lessee.
2. In addition, the whole amount which is invoiced to the Land Owner shall be booked as a receivable in return for the construction activity. The total booked receivable shall be divided into the number of years for which the lease agreement will be in force, and in the each year, the respective receivable amount which will not be collected from the Land Owner shall be set off to the lease payments and considered as a deductible expense in the calculation of the income tax base.
3. The lease payments made to the Land Owner shall be subject to income withholding tax at the rate of 20% in case the Land Owner is an individual.

Part 4: The Scope of the Renouncement of the VAT Exemption for the Sale and Lease Back Transactions

Within the scope of sale and lease back transactions;

- The Sale of the immovable properties to a financial leasing company,
- Leasing of the immovable properties by the financial leasing company to the lessee (seller) and
- Transfer of the ownership of the immovable properties back to the lessee (seller) by the financial leasing company

are exempt from Value Added Tax according to Article 17/4-y of the Value Added Tax Code ("**VAT Code**") (Law No. 3065) (*published in the Official Gazette dated 02 November 1984, No. 18563*).

Moreover, under Article 18 of the VAT Code, taxpayers have the right to renounce the VAT exemption to be applied on their transactions. Under the same, taxpayers shall apply to the relevant tax office with a petition in order to be subject to VAT for the exempted transactions. The renouncement of the VAT exemption will be applicable for all similar transactions. Upon the application, taxpayers shall be bound with their application for three years and their requested transactions shall be subject to VAT for the same period.

Upon the application of the lessees to financial leasing companies to make sale and lease back transactions by applying VAT on those, the Financial Leasing, Factoring and Finance Companies Association has applied to the Tax Authority for a tax ruling on the tax treatment in the case of the renouncement of the VAT exemption.

Under the tax ruling application petition, two main questions were raised to the tax authority; 1) Is the renouncement of the VAT exemption only applicable for the sale of the immovable property by the lessee to the financial leasing company or does it also include the lease back and transfer of the ownership of the immovable properties by the financial leasing company? 2) In the case of the renouncement of the VAT exemption, is the financial leasing company deemed to renounce from the VAT exemption for all sale and lease back transactions to be performed with its other customers. The Tax Authority has responded to the abovementioned queries in its tax ruling dated 28.02.2014 and No. 23814 as follow:

- 1) The sale and lease back transaction consists of three complementary and integral stages; i) sale of the immovable property to the financial leasing company ii) lease back of the immovable property to the lessee (seller) iii) transfer of the ownership of the immovable property to the lessee (seller). Such transactions constitute integrity and could not be considered as separate transactions. Therefore, it is not possible to

benefit from the VAT exemption or denouncement of the VAT exemption for only one part of that transaction.

- 2) In the case of a denouncement of the VAT exemption, all other sale and lease back transactions performed by the financial leasing company which has denounce from the VAT exemption would be subject to the VAT in accordance with the general provisions of the VAT Law.

Part 5: The Resource Utilization Support Fund Treatment in case of the Extension of Foreign Currency Loans Received Abroad

As it was explained in our Legal Alert: Tax 2013/1; pursuant to the Council of Ministers Decree No 2012/4116, Resource Utilization Support Fund (*published in the Official Gazette in August 26, 2006 and No. 20264*) (the “RUSF”) rates have been determined again with regard to foreign currency and gold loans extended by foreign residents to Turkish residents other than banks and financial institutions, which will be applicable to the loans granted after January 02, 2013.

In this respect, The Banks Association of Turkey has applied to the Tax Authority for a tax ruling on the RUSF application of the loans granted before January 02, 2013 but extended after January 02, 2013. The Tax Authority has provided its opinion with the tax ruling dated February 13, 2014 and No.17483 as follows:

- Each extension of the foreign currency loan shall be considered **as a new loan** and the RUSF shall be levied over each extended loan in accordance with the RUSF regulation which is effective on the extension date,
- In relation to a loan obtained abroad before January 02, 2013;
 - If the extension was made before January 02, 2013, such loan shall be considered as a loan granted before January 02, 2013, and it shall not be subject to any RUSF withholding providing that the average maturity of the loan is longer than 1 year.
 - If the extension was made after January 02, 2013, the extended loan shall be subject to RUSF based on its average maturity within the scope of Decree No 2012/4116.

Therefore, the Tax Authority is in the opinion that a loan extended after January 02, 2013 shall be treated as a new loan and shall be subject to RUSF from 0% to 3% depending on its average maturity. However, we do not agree with the Tax Authority on the basis that the loan extended after January 02, 2013 should not be treated as a new loan and shall be subject to 0% RUSF providing that its average maturity is longer than 1 year since the loan is still the same and there is no change in terms of the provisions of the loan other than its repayment dates.

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