GEDİK & ERAKSOY

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Capital Gains Tax exemptions under the Draft Income Tax Law

*The Draft Income Tax Law (the **Draft Law**) is currently at different commissions in the parliament, where it is still being negotiated. There is no clear guidance as to when such Draft Law will be approved in the Turkish Grand National Assembly (enacted) and become effective. The Draft Law brings substantial changes to the taxation regime in Turkey. Please see below relevant changes envisaged to be made to the corporate tax regime, which may be essential in terms of different applications of the Corporate Tax Law (**CTL**), currently in force and the Draft Law, in capital gains tax exemptions.*

The Draft Law aims to abolish the current Income Tax Law (**ITL**) and CTL and to replace them with the new Income Tax Law, which will cover both corporate and income tax provisions. The Council of Ministers' discretion on income and corporate taxation has been expanded to establish a flexible fiscal approach and to increase efficiency. As per the preamble of the Draft Law, the merger of the dual regime consisting of two different laws is one of the main reference points of the legislative process, which intends to provide a more foreseeable taxation regime. Accordingly, with the enactment of the Draft Law repetitions and references between ITL and CTL will be removed to provide consistency in the legislation.

As per the Draft Law's preamble the Draft Law aims to incentivize the investment, production, employment and savings in Turkey and provides a variety of incentive and support schemes to that end. Under the Draft Law, the applicable corporate tax rate is 20 % bringing no changes to the current rate under the CTL. Under the Draft Law discounted corporate tax regime will be referred to as the discounted income tax; however, the provisions and incentives will remain unchanged. Furthermore, incentives for export in services are envisaged under the Draft Law.

There is a substantial change in the provisions governing capital gains tax. For corporate entities, under the current provisions of the CTL, 75% of the capital gains arising from the sale and transfer of shares of a full taxpayer company, which were held for more than two years by the legal entity (*i.e.* corporate entity) shareholder, is exempt from capital gains tax, provided that the 75% portion, which is exempt from the capital gains tax must be booked in liabilities under a special fund account for five years following the year in which the share sale and transfer is consummated. The Draft Law provides gradual tax exemption over the income generated through the sale and transfer of shares in different levels, depending on the length of holding such shares by the transferor.

Pursuant to the Draft Law:

(a) 40 % of the income, generated from the sale and transfer of the shares held for more than two full financial years;

(b) 50 % of the income, generated from the sale and transfer of shares held for more than three full financial years;

(c) 60 % of the income, generated from the sale and transfer of shares held for more than four full financial years;

(d) 75 % of the income, generated from the sale and transfer of shares held for more than five financial years;

is exempt from capital gains tax. This exemption is applicable at the term of the sale and transfer transaction and the portion, which is exempt from the capital gains tax must be booked in liabilities under a special fund account for five years following the year in which the share sale and transfer is consummated. Furthermore, income generated from the sale of the shares of a limited liability company (*limited şirket*) falls within the scope of the exemption in the Draft Law, as opposed to the ITL.

In line with OECD regulations, business people, experts, government officials and media workers will be subject to the full taxpayer regime, provided that such persons resided in Turkey for 183 or more days within an uninterrupted 12 month period.

The tax return regime will change under the Draft Law as deadlines for tax returns will be pushed back for one month and 4th term provisional tax return will be abolished.

Tax supervision institutions, which will be authorized to safeguard and supervise certain tax instruments, such as the imputed rent income, thin capitalisation, disguised profit distribution through transfer pricing, controlled foreign corporation gains and withholding taxation of payments to the countries creating a detrimental tax competition, are regulated within the Draft Law in a separate section.

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