New Incentives Package Announced

Following the establishment of the Ministry of Economy after the most recent general elections, both Turkish businesses as well as foreign investors had been waiting for the announcement of a new incentives package. Prime Minister Recep Tayyip Erdoğan announced the incentives package on 5 April 2012. This was followed by a detailed informative briefing by the Minister of Economy, Zafer Çağlayan.

The new incentives package is comprised of four main components, namely (i) general incentive implementations; (ii) local incentive implementations; (iii) incentives on large-scale investments and (iv) incentives on strategic investments. The new incentives package aims to reduce Turkey's current account deficit, by drawing manufacturing activities to inside of Turkey and through the transition from a labor-intensive system to a knowledge-intensive system.

General Overview

The new package envisages Value Added Tax (VAT) and Customs Tax exemptions, tax reductions, insurance premium aids to employers, interest aids, land allocation, withholding tax aids and VAT refunds. Incentives are to be provided particularly to strategic investments that will improve the structural integrity of the industry, through domestic manufacturing of the goods that are otherwise imported.

Within this framework, a large number of investments, regardless of location, will receive incentives under the same conditions. Such incentives will include:

- ✓ Customs Tax and VAT exemptions for tooling and other equipment;
- ✓ Insurance premium aids for employers, for a period of seven years following the completion of investment;
- ✓ Tax reductions amounting to 50% of the total investment value;
- ✓ Investment aids of up to TRY 50 million by governmental coverage for the interest of investment credits for the first 5% of the fixed investment value; and
- ✓ VAT refunds for construction expenses, for investments of more than TRY 500 million

The VAT refund is expected to mitigate the financial burdens of investors. VAT advantages had been provided in previous incentives packages, but a total refund for investments amounting to at least 500 million is going to be implemented for the first time.

Local Incentive Implementations

The package divides Turkey into six regions, based on economic development levels. Unlike previous regional divisions, the new incentives package introduces regional division on a provincial basis. Accordingly, the economic development level of each province will be analyzed and classified separately, based on 61 different criteria. According to Prime Minister Erdoğan, the levels of provinces will be updated every year by the Ministry of Development, upon periodical studies of the Turkish Statistics Institute.

The intensity of incentives is dispersed throughout the country and the investments made in geographical regions of eastern Turkey. The 5th and 6th regions will receive more favorable incentives. In one remark, Prime Minister Erdoğan stated that an investor investing in the 6th region will only have to bear the net minimum wages as the total employment cost and any investment made within the 6th region will receive favorable incentives regardless of the sector of investment.

The new system brings tax reductions for all of the income generated from the entirety of investment. This means that an investor investing in any region, except for the 1st region, will benefit from the tax reduction, regardless of the scope of investment.

The margins of tax incentives to be implemented for the income generated from the out-of-scope operations will be: 10% for the 2nd region; 20% for the 3rd region; 30% for the 4th region; 50% for the 5th and 80% for the 6th region.

The incentives package has defined the 6th region as the "provinces of priority". These provinces are Ağrı, Ardahan, Batman, Bingöl, Bitlis, Diyarbakır, Hakkari, Iğdır, Kars, Mardin, Muş, Siirt, Şanlıurfa, Şırnak and Van. If any investor investing in a province different than the above expands its investment into one of these provinces, the highest level of incentives will be applied to the entirety of its investments, including the ones that are not in the said provinces. According to Minister Zafer Çağlayan, investment costs can be reduced by up to 50% with the application of tax reductions in these provinces.

Strategic Investments

The new package sets out several sectors in which slightly more favorable incentives will be provided. Some of the most noteworthy of those sectors are education, automotive, aviation, space, transportation, defense, wind tunnels, mining, tourism in the designated areas and special pharmaceutical investments aiming to manufacture biotechnological and oncological supplements. Investments in these sectors will receive incentives at least at the level of those provided for the 5th region.

Incentives for strategic investments include an incentive for costs arising from the construction of premises, whereby such costs will be subject to a tax return. Accordingly, VAT (18%) paid at the construction stage will be refunded to the investor. This incentive will apply to investments exceeding USD 500 million. Minister Çağlayan stated that investors will save approximately USD 180 million on an automotive manufacturing facility, where the estimated investment is in the amount of USD 500 million.

Moreover, the corporate tax reduction rates for the said investments have been determined. These will be applied starting from 1 January 2012, to investments made up to 31 December 2013.

Insurance Premiums

An insurance premium aid is also planned within the new incentives package, to be effective on investments made up to 31 December 2013. This aid is based on the insurance premium corresponding to the total minimum wages of investors' employees, to be covered by the government on behalf of investors. For investments made in the 6^{th} region, the insurance premium aid will be implemented for ten years. For investments to commence after this date, the premium aid will be implemented for seven years.

Organized Industrial Zones

Investments made in organized industrial zones will benefit from incentives made available to one region ranked lower. Similarly, the rate of incentives will increase by 5% for investments made in organized industrial zones located in the 6^{th} region (55% for local incentives and 65% for incentives on large-scale investments).

Insurance premium aids will also be provided to investments made in organized industrial zones for a term of 12 years, offering a longer aid period compared to that of investments made outside such zones, which is ten years.

Research and Development

As the new incentives package aims to support the gathering of investments into a zone allocated for research and development, it encourages investors to be engaged in strategic partnerships to carry out research and development activities for manufacturing and innovation, by allowing them to benefit from incentives made available to the one region ranked lower.

Conclusion

The package has received positive feedback in the commercial sector. It is expected to encourage investment in various areas of Turkey. Zafer Çağlayan has stated that the Ministry of Economy will establish an information center for informing investors on the new incentives system. However, the legislation regulating the abovementioned investments has not yet been prepared. According to recent reports from the Ministry of Economy, the implementation date of the new incentives may be postponed to June 2012. In light of the above, although these incentives provide a variety of benefits for the investors, the picture of the incentives package will be clearer once the legislative framework is officially prepared.

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