English translation

New business opportunities in trade: Korea free trade agreement

Free Trade Agreement (FTA) concluded with Korea has been signed in Ankara on 1 August 2012, and parties are expected to complete their domestic approval processes for the entry into force of the agreement. After the approval procedures, the agreement is expected to become effective in the first quarter of 2013. This agreement signed with Korea has a particular importance as it is the first Free Trade Agreement which our country has concluded with Far Eastern countries.

After the Turkey-Korea Free Trade Agreement becomes effective, considering the distribution of the products imported from Korea, we are of the opinion that the agreement will significantly affect our input supply structure and offer great advantages in terms of our input costs. This is because the agreement stipulates that the customs duties shall be mutually set to zero at the end of maximum seven years for all industrial products. Since the gradual reduction of import duties will also gradually decrease the costs of imported goods, we can easily conclude that this cost advantage will provide a competitive advantage to business owners conducting trade with Korea.

On the other hand, the rules regarding proof of origin have been defined differently in the free trade agreement signed with Korea, from other free trade agreements. In terms of "proof of origin", it has been deemed sufficient to state the expression which shows that goods originate from that country on the invoice. Therefore, in imports from Korea or exports to Korea, no additional document will be used to check whether or not products have fulfilled the conditions for the acquisition of originating status. In this case, business owners will assume another responsibility for the determination and detection of the origin of goods. Therefore, the rules of origin in the agreement should be analyzed in detail per sector and product, and it should be ensured that these rules are met.

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Changes introduced to the private pension system by Law no. 6327

"Law No. 6327 Regarding Amendments to the Private Pension Savings and Investment System Law and Certain Laws and Decree Laws", which is regarded as a new milestone in private pension system, has been published in the Official Gazette dated 29 June 2012.

From a general perspective, by introducing new regulations to the Private Pension System (PPS), which can be utilized as a long-term saving instrument, has become more attractive thanks to the new regulation, while the purpose of the system is to make persons save money.

Law no. 6327, which contains profound changes, has cancelled the deduction of PPS contributions from tax base within certain limits; instead of this application, "State contribution" has started to be implemented. The effective date of this application has been determined as 01.01.2013.

1. Calculation of state contribution

The law states that, other than those paid by employers, the State contribution amount corresponding to 25% of the contributions paid to the private pension account in the name of the participant shall be calculated by the Pension Monitoring Center (PMC) on the basis of the information reported by private pension companies, and this amount shall be transferred to the accounts of participants from the appropriation within the budget of the Undersecretariat of Treasury. Furthermore, no amount shall be transferred from this appropriation in the budget of the Undersecretariat of Treasury to other budget items by any means, and State contribution shall be separately followed from other contributions paid by participants. The evaluation of these amounts is at the initiative of the Undersecretariat of Treasury. Besides, State contribution may not be seized, given as pledge or included in the bankruptcy estate.

In the calculation of State contribution, only the contributions paid in the name of Turkish Citizens and transferred to company accounts in cash will be taken into account; for the contributions paid with credit cards to be included in the calculation of State contribution, they must have been transferred to the account of pension company in cash.

2. "Certain requirements" for entitlement to State contribution

Contributions paid to private pension account as State contributions in the name of participants are limited with 25% of the contributions paid by participants. However, the additional contributions to be paid by the State have also an upper limit; State contribution amount may not exceed the amount calculated on 25% of total annual minimum wage. Therefore, in PPS payments that exceed minimum wage, State contribution will be limited with 25% of minimum wage again. On the other hand, in the calculation of the annual minimum wage to be taken into account in the calculation of the maximum amount, gross minimum wage amounts determined for the first and second half of the year are separately taken into consideration.[1]

The matter can be explained with the following example. For a person paying a contribution of TL 3.600 in total in 2013, State contribution will be calculated as TL 900 (TL 3.600*25%). However, for a person paying a contribution of TL 15.000, additional contribution to be paid by the State will not be calculated as 25% of TL 15.000, but 25% of TL 12.000,60 (annual minimum wage), that is, TL 3.000,15.

Another significant point here is as follows: Even if State contribution is 25% of the amount paid by a person, in order to be entitled to this whole amount, the person must quit the system due to retirement, death or disability. In order to be retired through this system, participants must remain in the system for at least 10 years and complete 56 years of age.

In case the abovementioned requirements are not fulfilled, persons will be entitled to a certain portion of this amount depending on the period in which they remain in the system. In the determination of these portions of entitlement to State contribution, the following periods will be taken into account:

- Those who remain in the system for at least 3 years shall be entitled to 15% of the State contribution and its returns, if any,

[1] Regulation on State Contribution in Private Pension System published in the Official Gazette no. 28512 dated 29.12.2012 , Article 5

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- Those who remain in the system for at least 6 years shall be entitled to 35% of the State contribution and its returns, if any,
- Those who remain in the system for at least 10 years shall be entitled to 60% of the State contribution and its returns, if any.

Other than these requirements, if any, the accumulated amount in the State contribution account which participants leaving the system have not been entitled to may be recorded as income for general budget or may be offset against the State contribution payment to be made to participants.

Provided that they remain in the system during 3 years as from 01.01.2013 (until 01.01.2016), at the end of 3 years, those who have previously joined the system shall be granted a one-time additional period which will be taken into account for the period in which they become entitled to State contribution:

- 1 year for participants who remain in the system for more than 3 years and less than 6 years,
- 2 years for participants who remain in the system for more than 6 years and less than 10 years,
- 3 years for participants who remain in the system for more than 10 years.

It should be noted that State contribution is applicable for individual participants, and it does not include the contributions paid by employers. Contributions paid by employers in the name of employees may be deducted as expense in the determination of business profit without being associated with remuneration as it was in the former system. However, these contributions which will be booked as expense without being associated with remuneration must not exceed 15% of the monthly salary derived in the month of payment and must not annually exceed the yearly amount of minimum wage. In case a payment which exceeds this amount is made, the exceeding portions must be grossed up as salary and included in the payroll. The rate of 15% used to be applied as 10% before the Law no. 6327 became effective.

3. Implications of the regulation on other tax laws

Law no. 6327 has also made various changes in other tax laws as well. While some articles have been totally abolished, some of them have been amended.

3.1 Inheritance and Transfer Tax Law

According to the clause which article 2 of Law no. 6327 has added to the first paragraph of article 4 of Inheritance and Transfer Tax Law no. 7338, the portion of the State contributions paid to private pension accounts, which participants have been entitled to have been exempted from inheritance and transfer tax. Although the State contributions transferred to the accounts of participants without any consideration are subject to inheritance and transfer tax, these amounts have been exempted from tax in order to avoid a possible tax liability due to the State contributions paid to the accounts of participants.

3.2 Income Tax Law (ITL)

Article 4 of Law no. 6327 has amended clause (9) of the first paragraph of article 40 of the ITL. This regulation about the expenses to be deducted in the determination of business profit states that total of the contributions which are paid to the Private Pension System by employers in the name of wage earners and will be deducted as expense in the determination of business profit without being associated with remuneration, may not exceed 15% of the remuneration derived in the month of payment and may not annually exceed the yearly amount of minimum wage.

Furthermore, there have been certain amendments to clause (3) of the first paragraph of article 63 of the ITL. It is inferred from the new wording of the article that personal insurance premiums may still be deducted from income tax base in principle. However, there are some amendments to the calculation of the deductible amount.

Accordingly, 50% of the premiums paid by employees for life insurance policies of wage earners, their spouses and young children and premiums for private insurance policies such as death, accident, health, illness, disability, unemployment, maternity, death and education paid by employees may be treated as deduction in the assessment of income tax base. However, the total of deductible premiums may not exceed 15% of the salary derived in month of payment and may not annually exceed the yearly amount of minimum wage.

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The maximum amount of personal insurance premium which could be deducted from tax base was limited with 5% of salary according to the former regulation; yet, the new regulation has determined this rate as 15%. In the calculation of the deductible amount, the yearly amount of minimum wage will be annually taken into account again.

Clause (15) of the second paragraph of article 75 of the ITL has been amended, and a new paragraph has been added to this article. In the former practice, withholding was applied to the whole amount of payments made by pension funds with a legal entity, support funds and insurance and pension companies to participants who quit the system. That is, all payments made were deemed income from marketable securities. This issue has been litigated by many times. With this new regulation, returns on contributions paid by participants and on State contribution are deemed income from marketable securities, and the most deterrent element of the regulations in PPS has been therefore eliminated. This provision became effective on 29.08.2012.

Law no. 6327 has also amended article 94 of the ITL. Accordingly, as from 29.08.2012, payments made by pension funds with a legal entity, support funds and insurance and pension companies will be subject to withholding under article 94. Since only the income part of the mentioned payments are deemed income from marketable securities as per the amendment to article 75 of the ITL, within the scope of article 94, withholding shall not be applied to the whole amount including principal amount, but only to the income part.

Parallel to the abovementioned amendment to clause (3) of article 63 of the ITL, article 89 of the ITL has also been amended. In the former regulation, personal insurance premiums paid by taxpayers who file annual income tax return on condition that 10% of the declared income (5% for personal insurance premiums) and the yearly amount of minimum wage are not exceeded could be deducted from tax base. In the new regulation on the other hand, personal insurance premiums (50% of the premiums pertaining to life insurances) paid may still be deducted from tax base, provided that 15% of the declared income and the yearly amount of minimum wage are not exceeded.

4. Resolution of the “disputed” matter

Another significant regulation introduced by Law no. 6327 is as follows: In case PPS participants quit the system due to any reason, the total amount of payments made (sum of principal and returns) will no longer be subject to withholding. According to another opportunity provided by the Law, of the taxes which were collected on the amount including principal, the portion which corresponds to principal money may be refunded.

It has been stated that this provision will become effective 2 months after the promulgation date of Law no. 6327, and this date is 29.08.2012.

Procedures and principles for the payment of this refund have been determined by Income Tax Circular no. 83. For the payment of refund, those entitled to refund must apply to the tax office where the withholding was deposited, the application must be filed before 29.08.2013, no lawsuit about withholding must be filed or the lawsuits already filed must be withdrawn. In short, the application must be filed within 1 year from the effective date of the article where this matter is mentioned.

5. Conclusion

Before Law no. 6327, participants could deduct the contributions from their tax bases if they were taxpayers. With the profound change, this application has been cancelled; instead, other than those paid by employers, 25% of the contributions paid by participants will now be calculated as State contribution.

Such steps taken for the purpose of increasing long-term savings and steadily maintaining economic growth will of course be beneficial. It is forecasted that these regulations, which are also believed to raise the awareness for long-term savings, will provide significant benefits both to individuals and the State by increasing domestic savings.

The amendment to the law has eliminated the approach that the amount of payments which corresponds to principal should also be subject to withholding if the participant quits PPS due to any reason, that is, the approach that all payments made should be deemed income from marketable securities. Therefore, this matter which was frequently disputed and mostly brought to court has been resolved.

The former application only allowed taxpayers to deduct their contributions from their tax base within certain limits, but did not allow other participants to benefit from this advantage. This application has been cancelled

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with effect from 01.01.2013, and new regulations have been introduced, offering advantages to a broader scope of participants through State contribution method.

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