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Turkey Introduces Tax Incentives for Leasing Certificates

Turkey has enacted an omnibus fiscal act that provides, among other things, various tax incentives relating to the issuance of so-called leasing certificates. The act (Law No. 6111, or the "Law") provides exemptions for value added tax (VAT), corporate tax, stamp tax and various other fees that would otherwise be payable in connection with leasing certificates. This development is expected to create a more "tax-neutral" environment for, and lead to an increased number of issuances of, leasing certificates.

Leasing Certificates

Leasing certificates are securities whose return is tied not to an interest rate, but to income derived from the leasing of certain underlying assets (movable, immovable or intangible assets). They have the same essential "sale-leaseback-acquisition" structure as the Islamic finance instrument *ijara sukuk*, where (1) the owner of an asset ("Originator") sells it to a special purpose vehicle (an asset leasing company, or "ALC") for a set purchase price, (2) ALC issues leasing certificates to investors in an aggregate amount equal to the purchase price, and uses the proceeds of the issuance to pay the purchase price to Originator, (3) ALC leases the asset to Originator and uses the income from periodic rent payments under the lease to make coupon payments on the leasing certificates, and (4) at the stated maturity of the leasing certificates (or at an earlier acceleration event), ALC sells the property back to Originator, and uses the proceeds of the sale to repay the principal amount of the leasing certificates (or in the case of acceleration, whatever amount is due and payable). Prior to the enactment of the Law, each of these transactions would be subject to various taxes.

Leasing certificates were introduced in Turkey in April 2010, when the Capital Markets Board promulgated the Communiqué on Principles regarding Leasing Certificates and Asset Leasing Companies, Serial: III, No: 43 (the "Communiqué") pursuant to the Capital Markets Law. However, since their introduction, only one Turkish issuer has issued leasing certificates (Kuveyt Türk participation bank issued \$100 million aggregate amount of leasing certificates in August 2010).

New Tax Incentives

The Law makes various amendments to existing Turkish tax legislation, creating specific tax exemptions for leasing certificate transactions. The exemptions are as follows:

- VAT tax will no longer be imposed on (1) the sale of the asset by Originator to ALC; (2) the leasing of the asset by ALC to Originator; (3) the delivery of the leasing certificates by ALC; or (4) the sale-back of the asset by ALC to Originator.
- Gains from the sale of the asset by Originator to ALC, and later by ALC to Originator, will no longer be subject to corporate tax, regardless of the holding period of the asset.
- Stamp tax will no longer be imposed on documents prepared in connection with (1) the sale of the asset by Originator to ALC; (2) if the asset is an immovable asset, the establishment of any

mortgage on the underlying asset; (3) the leasing of the asset by ALC to Originator; (4) the issuance of the leasing certificates by ALC; or (5) the sale-back of the asset by ALC to Originator.

- Various fees under the Law on Fees will no longer be imposed on (1) the sale of the asset by Originator to ALC; (2) the establishment of any mortgage on the asset; and (3) the sale of the asset by ALC back to Originator. Examples of such fees are title deed registration fees, any applicable notary public fees, and any applicable fees regarding transfer of intangible assets.

Applicability to Public Financing

While the Communiqué has made leasing certificates available as a private financing instrument, there is still no application of the "sale-leaseback-acquisition" financing structure to state-owned property in Turkey. A draft law regarding the use of state-owned property as a means of public finance was prepared by the Treasury as early as 2003, but it has not yet been considered by the legislative branch.

In the meantime, the Turkish government has been encouraging the development of Islamic finance instruments through other means. Earlier this year, the Istanbul Stock Exchange launched the first Participation Index, comprising 30 equities that conform to Islamic investment principles. In October 2010, the Central Bank of Turkey became one of the founding members of the International Islamic Liquidity Management Corporation, whose primary objective is to issue, and facilitate greater investment flows of, Islamic financial instruments. Also last year, the Capital Markets Board entered into a memorandum of understanding with the Securities Commission of Malaysia (where the majority of *sukuk* instruments are originated) regarding ongoing cooperation.

Analysis

The tax incentives introduced by the Law should be significant for Turkish issuers (especially "participation banks," which do not issue interest-bearing securities), providing a new mechanism for them to raise long-term financing.

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