



## PRIMETAX GUIDE:

# THE NOTIONAL INTEREST DEDUCTION FOR CASH CAPITAL INJECTIONS IN TÜRKİYE

Türkiye introduced a compelling tax incentive, the Notional Interest Deduction (NID), to promote equity financing and bolster domestic enterprises' capital structures. Implemented as of July 1, 2015, this policy allows Turkish resident companies—excluding those in the banking, finance, and insurance sectors—to deduct a calculated notional interest amount from their corporate income tax (CIT) base, provided that the capital contribution is made in cash. This policy, designed to ensure a fair and equitable tax system for all eligible companies, provides a level playing field for businesses, fostering a sense of justice and fairness.

At its core, the NID encourages companies to favour equity over debt by providing a tax benefit tied to the capital they invest in themselves. The deductible interest amount is calculated by applying the annual weighted average interest rate on loans provided by Turkish banks, as published by the Central Bank of Türkiye (CBRT), to qualifying cash capital contributions.

These may include either the cash portion of capital increases or the initial capital of newly established companies. However, only 50% of the calculated notional interest can be deducted from the taxable profit to ensure a balanced incentive application.

Eligibility for this deduction is contingent on the company having a taxable profit in the relevant period. Suppose a company is in a loss position due to prior-period carry-forward or current-year tax losses. In that case, it is not eligible to benefit from the NID for that period. Additionally, the legislation imposes several exclusions to maintain the integrity of the incentive. Increases in capital originating from in-kind contributions, internal reserves (e.g., retained earnings or legal reserves), mergers, demergers, acquisitions, or shareholder loans are not considered eligible for the deduction.

The scope and effectiveness of the NID were significantly expanded under Decree No. 2015/7910, which introduced differentiated deduction rates for various types of companies and investments. For instance, publicly traded companies listed on Borsa Istanbul (BIST) benefit from an additional 25 or 50 basis points on the interest rate used in the deduction calculation, depending on specific listing criteria. Likewise, investments made under government-approved incentive schemes are granted an additional 25 basis points. Companies not falling into these categories or restricted sectors are eligible for a general 50 basis-point enhancement.

However, the decree also specifies conditions where the deduction rate is 0%. This occurs in cases where passive income, which includes income from dividends, interest, and rental properties, constitutes at least 25% of a company's total income, and at least 50% of total assets consist of affiliate securities, shares, or subsidiary companies. Affiliate securities refer to stocks or other financial instruments issued by companies related to the company in question, such as parent or sister companies. Similarly, companies heavily invested in real estate are limited to a deduction equal to the corresponding real estate investment amount.

Subsequent legislative amendments reinforced the incentive. Notably, Law No. 7338, enacted on October 26, 2021, elevated the deduction rate to 75% for cash capital contributions from abroad—a strategic move to attract foreign investment into Turkish enterprises. Following that, Law No. 7417, passed on July 1, 2022, allowed companies to utilise the deduction across five consecutive accounting periods, beginning with the year in which the capital increase or initial registration of the articles of association occurs.

The formula to determine the deductible amount from corporate income tax is as follows:

Deductible Amount = Cash Capital Contribution × CBRT Interest Rate × Duration (Months) × Discount Rate

For example, assuming a cash capital increase of 100,000 units, a CBRT interest rate of 13.54%, 12 months, and a discount rate of 75%, the deductible amount would be calculated as follows:

$100,000 \times 0.1354 \times 12 \times 0.75 = 121,860$  units

This amount is deducted against the company's taxable base, reducing its corporate tax liability accordingly.

To support long-term financial planning, companies can monitor the applicable interest rates on the Central Bank of Türkiye's official portal. For instance, they can set up alerts for any changes in the published rates to ensure they are always aware of the current rates.

It's also important to note that the capital injected under this scheme can be deployed strategically, such as through term deposits, to generate additional interest income, thereby enhancing overall returns and maximising the value of the capital contribution. This strategic use of the NID empowers companies to optimise their financial planning and maximise returns, instilling a sense of control and empowerment in their financial decisions.

In conclusion, the Notional Interest Deduction represents a well-designed fiscal tool for Turkish resident companies seeking to strengthen their capital base through cash contributions. Türkiye's continued alignment of its tax policy with global best practices reassures the audience of its commitment to stimulate economic growth and promote equity financing by offering a partially deductible notional return on invested equity, especially with a higher rate for foreign-sourced capital.

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