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An Alternative Way to Have a Presence in Turkey – Liaison Offices

By: Serap Zuvin, Esq.

Serap Zuvin Law Offices *

Beybi Giz Plaza, Maslak Mahallesi, Meydan Sokak
No: 1 Kat: 31 Daire: 121, Maslak, Sisli
Istanbul, Turkey 34398
Tel: +90 212 2807433
Fax: +90 212 2781911
Website: www.zuvinlaw.com.tr

**Member of Primerus*

For assistance, contact:

Chad Sluss
Senior Vice President of Services
Email: csluss@primerus.com
Phone: 1.800.968.2211 or 1.616.454.9939, ext. 3628

AN ALTERNATIVE WAY TO HAVE A PRESENCE IN TURKEY: LIAISON OFFICES

*By Serap Zuvin
Serap Zuvin Law Offices
Istanbul, Turkey*

Why Establish a Liaison Office?

Under the equal treatment principle, as stated in Article 3 of the Law on Direct Foreign Investments¹, foreign investors can freely establish the same types of companies as Turkish citizens. However, this presents a question: is establishing a company always the most cost efficient and preferable way to enter into a local market, especially when the investor intends to have a presence in that particular market but has not yet decided to commit to a full investment? When this is the case, a foreign legal entity investor may not prefer to establish a company in Turkey immediately, but instead choose to create a liaison office, a more simple mechanism that has been available to foreign investors in Turkey since the 1980's.

Does a Liaison Office have a Viable Presence?

Liaison offices are not entitled to conduct commercial activities. Nevertheless, liaison offices permit investors to both enhance their presence in Turkey and to plan for future investment in the Turkish market. Liaison offices can conduct market research, promote the products and services of the investing company, handle the regional management headquarters, *etc.* Accordingly, liaison offices are a perfectly viable presence for foreign investors who are not yet committed to performing commercial activities in the Turkish market.

¹ Law on Direct Foreign Investments dated June 5, 2003 and numbered 4875 and published in the Official Gazette dated June 17, 2003 and numbered 25141.

What Should I Know to Establish a Liaison Office in Turkey?

Foreign companies may incorporate liaison offices in Turkey pursuant to Article 6 of the Regulation on the Implementation of Direct Foreign Investments² (“Regulation”). Pursuant to Article 6, the Ministry of Economy of the Republic of Turkey (the “Ministry”) is the competent authority to issue both the permission of establishment for a liaison office and the extension of permission for one already established.

All expenditures made for the operation of a liaison office must be brought into Turkey by the foreign investor parent company and those funds must be in the foreign currency. However, there is no minimum capital requirement for the foreign investor, which differs from establishing of a company. Of course, the amount of funds which will be required for the liaison office depends on the type of activities that the liaison office intends to conduct.

In order to receive funds from the parent, the liaison office must have a bank account opened in Turkey. However, in practice, this requirement is fulfilled by the foreign investors quite easily and quickly because various global banks have a presence in Turkey.

Liaison offices are required to submit an annual activity report to the Ministry to inform them of the foreign currency transferred from abroad and the expenses covered with those received amounts.

Liaison offices can conduct their activities for a period of three years starting from their date of establishment. To extend this initial term, the liaison offices must apply to the Foreign Investment and Incentive Implementation General Directorate department under the Ministry (“Directorate”) before the expiry of their initial term. The Directorate evaluates the application regarding the extension based on a review of the activities of the liaison office, the business plan of its parent company for Turkey, *etc.*

² Regulation on the Implementation of Direct Foreign Investments; published in the Official Gazette dated August 20, 2003 and numbered 25205.

Commercial Activities: A Forbidden Fruit for Liaison Offices

As stated earlier, liaison offices are not allowed to conduct commercial activities. Although the exact scope of the term “*commercial activities*” has not been defined under the applicable legislation, our interpretation is that providing goods or services to clients in Turkey and invoicing those clients from Turkey should constitute commercial activities. With this interpretation in mind, the following activities should not be considered to fall under the scope of commercial activities: gathering information, conducting market research, representing and hosting, providing technical support, and even serving as the regional management headquarter of the parent company.

If the Directorate determines that a liaison office is involved in commercial activity then its permission will be cancelled.

What about Taxation?

Since liaison offices cannot engage in commercial activity, they do not generate any taxable income. This is why liaison offices are not subject to corporate income tax, and consequently, they are not required to submit corporate tax returns. Liaison offices are not obliged to keep formal books of account either.

Liaison offices are not Value Added Tax (“VAT”) payers because they do not conduct commercial activities in Turkey. On the other hand, they have to pay VAT at the time of their purchases of services and/or goods as a customer. As a result, no VAT refund or off-setting system is available to liaison offices because it is not possible for the liaison offices to issue invoices and add VAT.

The employee salaries, which are paid in foreign currency by the foreign parent company of the subject liaison office, are deemed as revenues generated outside of Turkey. Thus, the revenues are exempt from both the income tax and the stamp tax. Similarly, other cash and in-kind benefits which can be provided to the liaison offices’ employees, such as

gas, lunch, health insurance, rent, family benefits, *etc.*, are also exempt from withholding tax payments.

Power of Attorney Considerations

The scope of the *power of attorney* is an important consideration when establishing a liaison office. The general manager of the liaison office makes decisions on behalf of the investing company in Turkey. Turkish liaison offices thus issue a power of attorney to legally entitle the general manager to make decisions and conduct daily business on the liaison office's behalf. The power of attorney's effect is determined by its scope. A narrow power of attorney would give the general manager a smaller amount of discretion to act, which would require the general manager to get a new power of attorney for new actions outside the original scope. This can be a cumbersome, inefficient, and time consuming process for both parties.

However, a broad power of attorney, which gives the general manager more discretion to act on behalf of the investing company, can be more efficient because the general manager does not need to repeatedly seek a new power of attorney for actions outside the power of attorney's original scope. Also, it is important to note that this broadening requires a trustworthy general manager to compensate for additional permission given.

The Decision

If you, as a potential investor, are contemplating an entrance into the Turkish market at some point, wanting to understand the Turkish market as a prudent investor before having a solid presence, and wishing to promote your products for preparation to your big entrance into the market, then you should consider establishing a liaison office.