

## Angel Investment System in Turkey

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The legal framework of the Turkish angel investment system is regulated by Articles 10 and 14 of the Code numbered 6327 Amending the Individual Pension Savings and Investment System Law and Certain Laws and Statutory Decrees ("**Code numbered 6327**"). The Regulation on Angel Investments ("Regulation") was adopted for the purposes of applying and implementing the Code numbered 6327. The Undersecretariat of Treasury is competent to implement, apply and audit this new system and relevant regulations.

The main rationale behind taking such legislative initiative is to fill the gap experienced by small enterprises in accessing financing sources. It is a well-known fact that due to the high level of risk involved in start-up or growth phases, small enterprises experience hardship and difficulties in terms of finding eligible financing and borrowing sources which will support their growth. The financial sources for new ventures are commonly expected to be provided by angel investors. In order to promote financing of small enterprises and entrepreneurs, the government determined to incentivize angel investors with tax grants in return for the financial sources they provide for small businesses.

## Benefits Granted to Angel Investors

Real persons who are licensed to become angel investors under the Regulation are entitled to benefit from tax deductions in compliance with the Income Tax Code, numbered 193 ("ITC"). The ITC and the Regulation explain the tax benefits in detail.

### A. Tax Deductions Under the ITC and the Regulation

Tax deductions in favor of the angel investors under the ITC and the Regulation are envisaged as follows:

#### 1. 75% Tax Deduction

As per Provisional Article 82 of the ITC and Article 4 of the Regulation, angel investors are allowed to deduct 75 percent of the capital that they invest under the angel investment system from their income and revenues subject to the annual return issued during the year in which the shares were acquired. This is provided that the shares are acquired after June 29, 2012 and held in hand for at least two years. This two-year period starts as of the date the capital is deposited in cash into the bank account opened on behalf of the company in which the investment is made. It should be noted that as a requirement for the initiation of the two-year period and in order for the angel investor to be able to benefit from tax deduction, capital subscriptions must be deposited to the bank account in cash.

The price of shares acquired by the angel investor must be kept in the exclusive bank account of the company. Management of the bank account shall be under the control of the company invested in by the angel investor, however expenses over a certain amount shall necessitate joint signature. Please note that this account may solely be used for the financing of the activities set forth in the company's business plan.

## 2. 100% Tax Deduction

The aforementioned deduction rate is applied as 100 percent for the angel investors who invest in companies that have research, development and innovations projects which were supported by the Ministry of Science, Industry and Technology (Bilim Sanayi ve Teknoloji Bakanlığı), Scientific and Technological Research Council of Turkey (Türkiye Bilimsel ve Teknolojik Araştırma Kurumu) and Small and Medium Industry Development and Support Organization (Küçük ve Orta Ölçekli İşletmeleri Geliştirme ve Destekleme İdaresi Başkanlığı) within the last five years.

## B. Validity Period for Tax Deductions and Maximum Deduction Amount

As per Provisional Article 82 of the ITC, the tax deductions set forth above in Section II.A shall be applied until December 31, 2017. However, please note that the Council of Ministers is authorized to extend this period for up to five years.

Please note that the annual deduction amount under the Provisional Article 82 of the ITC cannot exceed TRY 1 million. However, the Council of Ministers has discretion to increase the deduction rate and maximum deduction amount by up to 50 percent and also to cancel out the aforementioned deduction rates and amounts altogether.

## C. Conditions for Benefiting from Tax Deductions

It must be noted that angel investments are subject to angel investment licenses. This will be explained in Section II.C.1.b below. In order to be entitled to angel investments and to benefit from the tax deductions, real person investors must obtain a license from the Undersecretariat of Treasury.

During the five-year license period, angel investors are entitled to benefit from tax deductions for their individual investments in up to 20 different joint stock companies.

In order to obtain the tax benefits explained above, angel investors must apply to the Undersecretariat of Treasury prior to investing in any company. At the same time the entrepreneurs must submit the company's articles of association to the Undersecretariat of Treasury. Subsequently, the angel investors are required to submit a business plan showing the purpose of the investment and for how long the capital will be used. It should be noted that the angel investors are not entitled to request from entrepreneurs any document of indebtedness, securities such as pledge or guarantees as to assignment or dividends against the capital invested by the angel investors.

The Regulation outlines in detail (i) the angel investor qualifications; (ii) the terms and conditions pertaining to the companies which the angel investors invest in, and (iii) lower and upper limits of investments in order for angel investors to be entitled to benefit from tax deductions.

# 1. Qualifying as an Angel Investor Under the Regulation

## *a. Being a Real Person*

In accordance with the Regulation, angel investors are defined as real persons conveying their own personal assets, experience and/or savings to start-up or growing companies that have a strong growth potential. Therefore, legal entities are not qualified to become angel investors nor benefit from the associated tax deductions. Only real persons may become an angel investor under the Regulation.

## *b. Obtaining an Angel Investor License*

To initiate angel investments and to benefit from tax deductions an angel investor needs to obtain a license from the Undersecretariat of Treasury. The validity period of license is envisaged as five years.

In accordance with the Regulation, (i) high income or wealthy investors and (ii) experienced investors are entitled to obtain an angel investor license provided that they are real persons. The Regulation provides monetary thresholds and requirements on an applicant's professional experience for the entitlement to obtain an angel investor license.

We should note that pursuant to the Provisional Article 82 of the ITC, angel investors cannot directly/indirectly or separately/together be the controlling shareholder of the company that they invest in. In the same manner, angel investors cannot join and invest in business if the company is owned, supervised, audited, controlled by, or directly/indirectly dependent on their spouses, or their descendants, ascendants or collateral relatives (including third degree collateral relatives).

The provisions of the Regulation are parallel with the Provisional Article 82 of the ITC. Angel investors cannot carry more than 50 percent of the voting rights. They also cannot appoint more than 50 percent of the board of directors on their own or in conjunction with themselves, or angel investor in conjunction with their spouses, or their descendants, ascendants or collateral relatives (including third degree collateral relatives).

Angel investors are entitled to hold privileged shares which grant the right to be represented on the board of directors of the company they invest in. The participation of the angel investor in the management of the company invested in by the angel investor is limited to participation in the general assembly, to the board of directors or to the advisory board or to the advisory committee. Angel investor can perform an administrative function only on the board of directors and cannot work as company personnel. An angel investor cannot receive any salary or other fees from the company. Non-compliance with these provisions shall result in the cancellation of the angel investor license.

# 2. Tax Deduction Application Through Angel Investors' Network

In order to be entitled to benefit from the tax deductions, angel investors must apply to the Undersecretariat of Treasury to obtain an angel investor license through an accredited angel investor network.

Angel investor networks are established by angel investors to gather the angel investors and the entrepreneurs.

The Undersecretariat of Treasury accredits and audits the angel investor networks. The accreditation period is set as five years. However, the Undersecretariat of Treasury may extend this period for periods of five years. In order to be accredited by the Undersecretariat of Treasury an Angel investor network must fulfill the requirements set forth in Article 34 of the Regulation.

If the accreditation of an angel investor network is cancelled the angel investments made before the accreditation cancellation date shall still be subject to tax deduction. However we should note that the angel investments made by the angel investors that are members of the cancelled angel investors network after the accreditation is cancelled shall not qualify for tax deductions. In the event an angel investor makes a license application to the Undersecretariat of Treasury through an angel investors network and the network's accreditation is cancelled after the application, the Undersecretariat of Treasury will complete the application procedures regardless.

We should note that until December 31, 2013 angel investors must apply directly to the Undersecretariat of Treasury in order to obtain angel investor licenses, to apply to receive the associated tax deductions and to declare angel co-investments. This is a transitional arrangement applicable while angel investment networks become established. After this date, angel investors must make these applications and declarations through the relevant angel investment network.

### 3. Conditions for the Company Invested in by the Angel Investor

For the angel investor to be entitled to benefit from tax deductions the company that the angel investor invests in must fulfill all of the following conditions:

- The company must be established in the form of a joint stock company under the Turkish Commercial Code numbered 6102; and
- The total amount of the pre-investment net sales of the company must not exceed TRY 5 million in either of the last two fiscal years; and
- The company must not have more than 50 total employees; and
- The company must not be controlled by another company; and
- The company must carry out its activities in the business sectors specifically determined by the Undersecretariat of Treasury; and
- The shares of the company must not have been offered to the public.

The principles pertaining to the companies invested in by angel investors are provided in the Regulation in detail.

### 4. Conditions Related to Sectors and Business

In order for angel investors to be entitled to benefit from the tax deductions the angel investment must be made in certain sectors and business areas that are determined by the Undersecretariat of Treasury. National Product and Business Classification (US-97) issued by Turkish Statistical Institute (TUIK) was taken into consideration when these sectors were being determined. These sectors and activities are given in detail as a list within the Regulation.

## 5. Conditions Related to Investments

In order for angel investors to be entitled to benefit from tax deductions the following upper and lower investment limits apply:

### *a. Lower Investment Limit*

In order for angel investors to be entitled to benefit from tax deductions the minimum capital amount invested in each company is set as TRY 20,000 per investment.

### *b. Upper Limit*

Angel investor's annual capital subscription to each company cannot exceed TRY 1 million. For angel co-investments, the maximum limit is TRY 2 million.

For the purposes of clarification, angel co-investment is defined as at least two angel investors investing together in a company. These shareholders are subject to the provisions for partners of joint-stock companies set forth in Turkish Commercial Code. Angel investors are entitled to freely determine a leading partner in the co-investment. The co-investors must jointly declare who the co-investment and leading partner are to the Undersecretariat of Treasury. If the angel investors invest in a company without this written declaration to the Undersecretariat of Treasury their joint investments are not considered to be angel co-investments and therefore the angel co-investors cannot benefit from the increased maximum investment limit provided for angel co-investments explained above.

Although the Regulation does not include a clear provision on this, it is understood from the interpretation of the provisions regulating the upper investment limit that a company is entitled to receive up to TRY 1 million of investment annually from one or more angel investors. In the event two or more angel investors come together and establish an angel co-investment structure this upper limit is increased to TRY 2 million.

## D. Tax Deduction Application to the Undersecretariat of Treasury

In order to obtain the associated tax deductions, an Angel investor must apply to the Undersecretariat of Treasury through the accredited angel investors' networks with the documents listed in the Regulation before making the investment.

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