

## CHAPTER XIV

### TAXATION POLICY

#### A- TREATY PROVISIONS (Arts. 95-99)

As we have noted in connection with the freedom of movement of goods<sup>1</sup> article 95 prohibits discriminatory taxes as being fiscal barriers to trade.

Article 96 provides for the repayment of taxes on exported goods which shall not exceed the level of internal taxation imposed upon them. This is to avoid a support or subsidy for exports.

Article 97, likewise, deals with the repayment of a turnover tax calculated on a cumulative multi-stage tax system. Article 99 envisages legislation for the harmonization of turnover taxes, excise duties and other forms of indirect taxation as far as necessary in the interest of the common market.

#### B- HARMONIZING LEGISLATION

The harmonizing process has been slow because taxation, like the monetary control, is among the last bastions of national sovereignty. However it is common ground that the harmonization of national taxes is a logical step towards the completion of the internal market as well as a consequence of the liberalization of capital movements.

#### VALUE ADDED TAX

In connection with the removal of the fiscal barriers to intra Community trade the Value Added Tax has been adopted as replacing customs duties and also providing a contribution to the Community budget as the Community "own resource".

The harmonization process began with two Directives of 1967<sup>2</sup>. The first VAT Directive consists of a general outline of the system, the definition of the VAT and the time-table according to which it should become part of a reformed tax system of the member states.

The second VAT Directive, replaced by the sixth Directive<sup>3</sup>, established a uniform basis for tax assessment. Whilst the member states were allowed to determine the rates of tax they were prohibited from applying different rates for imported and domestic goods, which would frustrate the effect of article 95 of the Treaty<sup>4</sup>. Thus the ECJ condemned as illegal the special tax applied only on imported "luxury" cars<sup>5</sup> and on imported cars with a taxable horsepower exceeding the largest capacity of cars manufactured in France<sup>6</sup>. A member state may, of course impose "luxury rate" on certain goods, including cars, provided it is not discriminatory<sup>7</sup>.

The Community VAT system applies to the supply of goods, i.e. the transfer of the right to dispose of tangible property as owner<sup>8</sup> or services which cover any transaction other than a supply of goods<sup>9</sup> and the importation of goods into the territory of a member state. "Importation of goods; in the wording of the amending Directive 91/680<sup>10</sup> means importation from third countries while "goods received from another state" means "Intra - Community acquisition" of these goods. "Export" means export to third countries<sup>11</sup>.

VAT is chargeable within the territory of a member state to "taxable persons"<sup>12</sup> that is persons or bodies who carry out "independently" (i.e. otherwise than as employed persons) certain economic activities. These activities include all activities of producers, traders, suppliers of services including agricultural mining and professional activities as well as the exploitation of property for continuous income<sup>13</sup>.

Member states may also include among the taxable persons anyone who performs on an occasional basis transactions related to the foregoing, in particular the supply of buildings or parts of buildings before first occupation and of the building land<sup>14</sup>. States, regional and local government authorities and other bodies governed by public law are not regarded as taxable in respect of the activities falling within their public competence<sup>15</sup>.

Zero rating is allowed for clearly defined social purposes<sup>16</sup> and so are exceptions<sup>17</sup>.

Transitional VAT arrangements were laid down in Directive 91/680<sup>18</sup> which were, in turn, simplified by Directive 92/111<sup>19</sup>. They are due to come into force by the end of 1996 in order to pave the way for the payment of VAT in the country of purchase. This will abolish the distinction between intra-Community transactions and transactions within a member state.

## EXCISE DUTIES

Excise duties, i.e. taxes on consumption of certain products (e.g. alcohol or tobacco) are next on the agenda. Directive 92/12<sup>20</sup> contains general arrangements for products subject to excise duty concerning their movement in the EC and providing for collection of excise duties once border controls have been abolished.

Directives 92/78-92/84<sup>21</sup> harmonized the excise duty structures and approximated duty rates on cigarettes and other manufactured tobacco, mineral oils and spirits and alcoholic drinks.

## DIRECT TAXES

The EEC Treaty does not deal with direct taxes (e.g. income tax and capital gains tax) but article 98 of the Treaty prohibits countervailing charges at frontiers, i.e. the application of remissions and repayments in respect of exports to other member states.

## ADMINISTRATIVE CO-OPERATION

In order to establish a framework for co-operation between the national tax authorities Regulation 218/92<sup>22</sup> provides for exchange of information on intra-Community trade subject to VAT and for a computerized network to make the co-operation effective. This should reduce the risk of tax avoidance.

Tax offenders are subject to national law: However criminal sanctions which can be imposed by national authorities may be mitigated by the Community principle of proportionality<sup>23</sup>.

## REPAYMENT OF UNDUE TAXES

Discriminatory taxes are treated like charges having equivalent to customs duties<sup>24</sup>. Being illegal they have to be repaid, but repayment follows the rules governing the return of taxes unduly collected<sup>25</sup>. However the taxpayer will not recover if the undue

tax was incorporated in the price of the goods and passed on to the purchasers<sup>26</sup>.

## C-TURKEY'S TAXATION STANDPOINT AGAINST EUROPEAN COMMUNITIES<sup>27</sup>

1-The General Outline of the Turkish Law System is as follows:

### The Legal Framework

#### a) Constitutional Structure of Turkish Tax Law:

Turkish Constitutions (1924, 1960) had covered contemporary Rules related to taxation. Article 73 of the 1982 Constitution, entitled "Tax Duty" lays down the following fundamentals of taxation;

- i) all individuals and legal persons, citizens or aliens are liable to be taxed.
- ii) taxes are intended to cover public expenditure.
- iii) taxes should be determined by law with regard to individuals with ability to pay.
- iv) an equitable and well balanced distribution of tax burden constitutes the social objective of fiscal policies.
- v) taxes and fiscal burdens likewise may only be imposed amended or abolished by Acts of Parliament.
- vi) the Parliament may delegate to the Council of Ministers the authority to make rules and to provide for immunities and exemptions of particular taxes and similar burdens or to amend the maximum and minimum limits laid down by the Acts of Parliament.

Article 91 of the Constitution does not allow Decrees having the force of Acts to regulate tax matters, except under martial law and in extraordinary conditions.

On the other hand article 167 (2) of the Constitution allows the Council of Ministers to be mandated by laws, to impose or to abolish subsidiary fiscal burdens on import, export and any other external trade transactions, in addition to taxes and similar fiscal burdens.

#### b) Structure of the Turkish Tax Law System

##### aa) General Approach

The Turkish tax law system displays a modern and contemporary appearance in conformity with generally accepted standards and procedures.

Indeed, the individual and corporate income are covered by Income Tax and Corporations Tax, whereas commercial, professional and agricultural transactions are subject to Value Added Tax.

Some 91 % of the General Budget revenues in 1993 shall be raised from taxes and fund contributions, social security contributions and municipal revenues not being included in this context.

Below is a chart for 1993 revenue structure of the General Budget:

### GENERAL BUDGET 1993

#### TAX REVENUES

	MillionsTL
Income tax	102.000.000
Corporations tax	15.000.000
Motor vehicles tax	1.700.000
Inheritance and transfer	300.000
Value added tax (domestic)	43.000.000
Value added tax (surcharge)	6.500.000
Value added tax (import)	25.000.000
Vehicle purchase tax	4.100.000
Fuel consumption tax	13.350.000
Banking and insurance transaction tax	6.000.000
Stamp duties	6.300.000
Fees	5.000.000
Customs duties	15.330.000
Residues of abolished taxes	20.000
Tax revenues	243.600.000
Fund revenues	68.790.000

The methods of tax controls, means of supplementary assessments, tax penalties and late payment charges comply with justice and equity.

- i) The existence of tax courts and the Council of State (Danıştay)
- ii) The methods of administrative correction of tax errors and,
- iii) The system of compromise; are the instruments redressing the balance between the taxpayer and the tax administration.

Accounting and audit standards and fiscal consultancy activities in Turkey are regulated in conformity with generally accepted international standards.

#### bb) Income Tax

Tax on individual's income has been instituted on the German Model (Kornersteuer) in 1950. Every individual is a taxpayer, i.e., a natural person resident in Turkey, citizen or alien who earns a taxable income.

Basically, resident tax payers are liable for their world-wide income, off-setting the tax paid on their foreign source income against the total tax computed in Turkey (full liability).

Non-residents are liable only on their income earned in Turkey (limited liability)

Subject to tax is the taxable income derived from the following seven sources, i.e. commerce, agriculture, professional services, labour, rent, interest and capital gains.

There is a wide span of withholdings like on wages, rents and interest. Income tax rates range from 25 % to 50 % in a progressive scale, the maximum average being about 41 %. Incomes of family members, i.e., husband, wife and children up to 18 years of age are assessed jointly, therefore raising the total to the higher bracket.

#### cc) Corporations

Corporate incomes are covered by the corporation tax, adopted from the German model (Korperschaftsteuer (1950)) Taxpayers are: i) joint stock corporations, ii) limited liability companies, iii) joint stock limited partnerships (practically non-existent), iv) cooperatives, v) public institutions, associations and foundations, business en-

terprises, vi) joint ventures established for the realization of particular constructions, vii) foreign entities which fit into the above mentioned cases as in (i) - (vi)

Taxpayers of full liability have their legal centre of business located in Turkey. They are in the same condition as defined in the income tax law. Foreign corporate bodies which have neither their headquarters nor business centres in Turkey are liable only for their gains acquired in Turkey. In this context, professional (service) gains and interest are subject to the withholding of the corporation tax.

The subject of corporation tax is the corporate gain which corresponds to "income" in income tax.

Besides the operational corporate gains, the liquidation gains are also subject to corporations tax, except specific "transfer" transactions as stipulated in the Corporation Tax Act.

There is a range of exemptions in corporation tax such as on export gains and investment deductions. However these are subject to lower rates of withholding and minimum tax rates which means that there is no zero rate tax burden on such so-called tax exempted gains.

The standard rate of corporation tax is 46 %. The Council of Ministers is vested with the authority to increase the rate up to 50 % or to fix rates as 40 %, 35 %, 30 % or increase each rate by 6 points.

#### dd) Value Added Tax

Value Added Tax (Katma Değer Vergisi) was introduced into the Turkish tax system effectively from January 1985 by Value Added Tax Act No.3065.

The Act vests the Council of Ministers and the Ministry of Finance and Customs with the authority to regulate particular matters such as fixing tax rates or tax exemptions.

VAT is imposed on all transactions at every level of production, distribution or services, related to commercial, industrial, agricultural and professional activities and transactions, except banking and insurance transactions.

Only supply and services within Turkey are subject to VAT. Therefore supply and services outside Turkey are not covered by VAT. Imported goods are also subject to VAT.

No distinction is made between resident and non-resident taxpayers or private and government entities performing the above taxable transactions, except in cases of exemptions stipulated in the VAT Act.

Exemptions in VAT may be grouped as follows: i) export of goods, ii) services rendered to clients located outside Turkey, iii) processing of goods for export, iv) supplies of sea, air or rail transportation vehicles, v) petroleum exploration activities, iv) transit transportation.

Value Added Tax Act sets the rate at 10 % for each transaction. However the Act authorises the Council of Ministers to decrease the rate to 1 %, increase it to 40 % or fix different rates within this bracket for particular goods and services.

Currently, the standard rate is 12 %. For particular items, the rates are fixed at 1 %, 6 %, 13% and 20 %.

#### ee) Other Taxes

Particular documents related to contracts, bills and transactions which are listed in Stamp Tax No.448 are subject to "stamp tax" which is calculated either on a per thousand basis or a fixed tariff.

Transfer of goods and valuables through inheritance or donations and gifts are subject to "inheritance and transfer tax"

"Real estate tax" which is a municipal tax comprises two components i.e. i) building tax and ii) and tax, levied on the value of the property. Other minor taxes are not included in this study.

#### ff) Fund Contribution

Starting from January 1993, an amount equal to 10 % of the assessed "income tax" or "corporations tax" is levied under the name of "fund contribution".

The Council of Ministers is authorized to fix the rate between 0 % and 10 % but the actual rate is fixed at 7 %. This replaces the previous contributions to Defence Industry Support Fund, Social Aid Fund and Vocational and Technical Education Fund.

#### II- Turkey's Tax Standpoint vis-a-vis the European Community

From a fiscal point of view, Turkey's relations with the EC can be seen in two spheres:

- i) present commitments of the parties to each other, and
- ii) Turkey's fiscal outlook as a prospective member state.

Turkey's present commitments to the Community are:

- i) to abolish the customs duties by 1.1.1996,
- ii) avoid fiscal levies and incentives having exequivalent effect, and,
- iii) comply with common customs rates related to third countries.

The European Community, on the other hand, has assumed responsibilities mainly related to labour, capital and goods movements and also fiscal policies.

In the course of time, Turkey:

- has lowered and adjusted customs duties and set the trend for the abolition of fiscal burdens having an equivalent effect to customs duties and the stamp duty on import,
- has been flexible with VAT rates,
- has abolished taxing dividends,
- has concluded double taxation treaties with most Community members, in conformity with the OECD model.

Institutionally, the Turkish tax law system fits the Community member states' tax systems. Disregarding the fiscal necessities- which are linked with the economic wellbeing of Turkey-particular distortions in tax matters can always be eradicated in order to achieve an ideal harmonization.. If accurately analysed, such distortions can be detected even in the present tax applications among the member states.

Nevertheless, three factors may be considered for Turkey's tax integration with the EC: i) fund contributions having equal effect, ii) protective incentives, and iii) Constitutional structure.

As for "fund contributions", the surcharge on income tax and corporation tax is considered as a component of those taxes. Therefore, in application of double taxation treaties, this contribution has to be considered. On the other hand, fund contributions and subsidies related to import transactions may be regarded as having equivalent effect to customs duties or protective incentives, which ought to be revised.

As for the protective incentives, Turkey has already abandoned the tax rebates on imports having the character of subsidy. However, foreign exchange oriented export exemptions may still be considered for revision. In fact, such exemptions (incentives) are being criticised also from a domestic viewpoint.

Concerning Turkey's tax law relations with the EC, the Turkish Constitution contains crucial provisions. The main authority is the Parliament which provides the mechanism for national adoption and approval of EC's requirements. However, disregarding such a necessity, presently, the current legislation allows the Council of Ministers to fix the rates of income tax, corporation tax, value added tax and withholdings within a very wide range of discretion. Regarding the value added tax, again, the Council of Ministers and event the Ministry of Finance and Customs are authorized to regulate its main application. Therefore, the Constitutional position and considerations should be revised in case of Turkey's membership.

The Constitution allows the Council of Ministers to impose additional levies on external trade which form part of fund contributions. In this case, the main power and authority is not the Parliament but the Government which can easily manipulate the system. Still, the object is to achieve an equal effect of fiscal burdens on external trade where it does not comply with the EC standards.

## NOTES

- 1 See Chapter VII
- 2 67/227, O.J. 1967, 14 and 67/228, O.J. 1967, 16
- 3 77/388, O.J. 1977, L.145/1
- 4 See Case 319/81 *Commission v Italy*, re VAT on spirits (1983) ECR 60
- 5 Case 112/84: *Humblot v Directeur des Services Fiscaux* (1985) ECR 1367
- 6 Cases 76, 86-89 and 149/87: *Seguda v Administration des Impots* (1988) ECR 2397
- 7 Case 200/85: *Commission v. Italy*, re VAT on Diesel cars (1988) ICMLR 97
- 8 Dir. 77/338, *supra*, art 5(1)
- 9 *Ibid* art. 6 (1)
- 10 O.J. 1991, L.376, art 7
- 11 *Ibid*. art. 1(12)(13)
- 12 Dir. 77/338, *supra*, art. 5(4) (b) (c)
- 13 *Ibid*. art. 4(2); See Case 89/81: *Staatssecretaris van Financien v Hong Kong TDC* (1982) ECR 1277
- 14 *Ibid*. art. 4(3)
- 15 *Ibid*. art. 4(5)
- 16 See Case 415/85: *Commission v Ireland* (1988) 3CMLR 189; Case 416/85: *Commission v U.K.* (1988) 3CMLR 169; Case 203/87: *Commission v Italy*, re zero rating for earthquake victims (1989) 2CMLR 461
- 17 Dir. 89/181 O.J. 1983, L.105/38; Case 252 /86: *Bergandi v Directeur General des Impots*, re tax on amusement arcade machines (1989) 2CMLR 933; Case 32/87; *Commission v Italy*, re VAT on veterinary services (1989) 3CMLR 844- unlike medical services veterinary services are not exempted
- 18 O.J. 1991, L.376
- 19 O.J. 1992, L..
- 20 O.J. 1992, L.76/1
- 21 O.J. 1992. L.316
- 22 O.J. 1992, L.24/1
- 23 Case 299/86; *Italy v Drexel* (1989) 2CMLR 241

24 Case 199/82: Amministrazione delle Finanze v San Giorgio Sp A (1983) ECR 3595

25 Case 33/76: Rewe Zentrale v Landwirtschaftskammer für Saarland (1976) ECR 1989; Case C-175/88: Biehl v Administration de Contributions (1990) 3CMLR 143

26 Case 199/82, supra; Cases 142, 143/80: Amministrazione delle Finanze v Essevi Sp.A (1981) ECR 1413.

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