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# Screening report

# Turkey

## Chapter 16 – Taxation

**Date of screening meetings:**

Explanatory meeting: 6-7 June 2006
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## I. CHAPTER CONTENT

The **indirect taxation** *acquis* consists primarily of harmonised legislation in the field of Value Added Tax (VAT) and excise duties. *Value Added Tax* was first introduced in the Community in 1967, eventually leading to the Sixth VAT Directive from 1977 which was codified in 2006. It includes the application of a non-cumulative general tax on consumption. This is levied on all stages of production and distribution of goods and services. The VAT *acquis* provides for an equal tax treatment of domestic and non-domestic (import) transactions. VAT is also based on the neutrality principle whereby the tax applied is proportional to the price, whatever the number of intermediate transactions.

In the field of *excise duties* the *acquis* contains harmonised legislation as regards energy products, tobacco products and alcoholic beverages. Community legislation establishes the structure of the duty that should be charged, together with a system of minimum rates for each product group. Goods are subject to duty when they are produced within the Community or imported from a third country. However, in principle, the duty is payable only to the Member State in which the goods are released into consumption (with certain limited exceptions), and at the applicable rates in that Member State. The EU legislation lays down provisions on production, holding, movement and monitoring of excisable goods. As a result of the introduction of the single market, all systematic fiscal controls at the Community's internal frontiers were abolished by 1 January 1993. As regards excise products, their holding and movement for commercial purposes within the Internal Market continued to be closely monitored to establish the chargeability of the duty.

The *acquis* in the area of **direct taxation** concerns certain aspects of profit taxes and capital duty. The focus is on eliminating distortions for cross-border economic activities between enterprises within the Union. It also includes provisions to ensure effective taxation of income from savings in the form of interest payments made to individuals. The *Code of Conduct* for business taxation represents a political commitment by Member States to tackle harmful tax measures. Member States are required not to introduce new harmful tax measures, and to roll-back existing ones.

The Community legislation in the field of **administrative co-operation and mutual assistance** between Member States' tax and customs authorities provides tools share information in order to circumvent tax evasion and tax avoidance. It allows gathering information about tax subjects, both automatically and on request.

The acquis in area of **operational capacity and computerisation** covers different areas of taxation. In the field of VAT, the *acquis* on the Value Added Tax Information Exchange System (VIES) provides for direct electronic interchange of data between national VAT administrations within the timeframe established in the relevant EU legislation. This allows national administrations to monitor and control intra-Community trade and detect possible irregularities. In addition, a specific IT system (VoeS) is required to establish the inter-connection for exchange of information among Member States related to the special scheme for e-Services provided by non-EU traders to EU citizens. Regarding excise duties, the EU *acquis* requires IT systems to allow Member States exchanging information on producers and traders of excisable products (SEED, MVS, EWSE and EMCS, the latter being under development). In the area of direct taxation Member States are required to put in place an automatic system for the exchange of information of savings income in the form of interest payments through an electronic standardised format.

## II. COUNTRY ALIGNMENT AND IMPLEMENTATION CAPACITY

This part summarises the information provided by Turkey and the discussion at the screening meeting. Turkey accepted the *acquis* regarding taxation and stated that it did not expect difficulties implementing the *acquis* by the time of accession.

As regards institutional and administrative capacity, the Ministry of Finance is the main body responsible for taxation. Policy making and implementation were recently separated. As a first step in 2005, the Presidency of Revenue Administration (PRA) was established as a semi-autonomous organisation attached to the ministry, t he intention being to reduce hierarchical layers and improve accountability of the local tax offices to headquarters. As a further step at the beginning of 2006, policy making passed to the newly created Directorate General of Tax Policy within the ministry.

The Tax Audit Coordination Board, chaired by the Minister of Finance, is responsible for preparing and coordinating an Annual General Tax Audit Plan. To improve the tax base, Turkey is preparing to set up a tax office that addresses the larger tax payers. Turkey has four bodies conducting tax audit: The Board of Finance Inspectors, the Board of Tax Auditors, the Revenue Controllers, and local tax auditors. The Board of Finance Inspectors and the Board of Tax Auditors are directly accountable to the Ministry of Finance. Revenue Controllers and local tax auditors are attached to the Revenue Administration. The Tax Audit Coordination Board (TACB), led by the Minister of Finance, is responsible for overall coordination. The TACB adopts a general audit plan annually. Tax Audit Units, taking into account the strategies and fields of risk as stated in the general audit plan, prepare the working plans.

### II.a. Indirect taxation

As regards ***Value Added Tax***, Turkey uses a general consumption tax covering all goods and services as envisaged by the *acquis*. Turkey's VAT legislation is based on Law No 3065 which entered into force on 1 January 1985. VAT is applied to all stages from producer to consumer and calculated on transaction values.

The Law provides for a standard VAT rate of 10%. The Council of Ministers is authorised to increase this rate up to four times, to decrease it down to 1% and to specify different tax rates for various goods and services. Currently, Turkey applies a standard rate of 18%.

Turkey also applies reduced rates of 1% and 8% for goods and services listed in respectively, List I and List II. In some cases, different rates at different stages in the supply chain apply. To combat tax evasion in certain economic sectors, a reduced rate of 1% is applied until the retail stage, while the normal rate is maintained for the retail sector. The reduced rate lists include certain agricultural products and foodstuffs (eg fruits, meat, baby food), goods and services related to cultural and educational field (eg newspapers, books, cinema, theatre), related to the social field (eg. wheel chairs, funerals), health sector (medicines, ambulance services), and a category 'other' (eg used motor cars, textiles, goods subject to financial leasing).

Under Turkish law taxable persons are defined as those carrying out supplies of goods or services; or in the case of imports, those who import goods or services, whether public or private. Those organising artistic and sports activities with the participation of professional artists and sportsmen, as well as the Directorate General of the Post, Telephone and Telegraph, and broadcasting corporations are also considered taxable persons.

As regards the scope of the tax, VAT applies to supplies conducted within the framework of commercial, industrial, agricultural, and self-employed activities, as well as imports of whatever kind. Supplies are generally established by issuing an invoice. However, the Turkish legislator has intended also to include in the scope, supplies where no invoice has been issued. If it is determined at an actual or registered inventory check that goods are held without documentation, or a service is purchased without documentation, the Value Added Tax is collected from the taxpayer who holds undocumented goods, or who purchases an undocumented service. Taxpayers who hold goods or purchase a service without documentation, are allowed a period of 10 days from the date of such determination to rectify and present the relevant documents. If a body conceals its commercial identity, it is held responsible for payment of VAT. A delivery of private property falls outside the taxable scope, because a taxable delivery needs to involve an economic activity.

Furthermore, Turkish legislation specifies that supplies of goods falling within the taxable scope include: gambling and other games of chance; professional performances and concerts, professional sports activities, games, races and competitions; mail, telecommunications, as well as water, electricity, gas, heating, air-conditioning, and similar distributions are considered as delivery of goods. Customary returned goods, packaging scraps and secondary materials do not fall within the taxable scope.

The taxable amount is defined as the value of the consideration for goods or services supplied. This value is the sum of money; benefit; services and values received, including transport, packaging, insurances, taxes, duties, charges, and miscellaneous incomes such as price difference and interest. For lotteries, the participation fee is considered the taxable amount. For sales in customs warehouses and auction halls the taxable amount is the final sales price. As regards jewellery, the tax base is the amount remaining after the price of gold and/or silver bullion is deducted.

VAT on imports of goods is assessed and collected by the Customs Administration. Goods which benefit from an exemption are not subject to VAT upon importation.

Turkish income legislation allows for deductions related to purchases and expenses for business activities. Transactions that are VAT exempt (or not subject to VAT) cannot be used for deduction. Nor can VAT of lost products be deducted: those who lost the products become final users and thus tax liable. In addition, VAT incurred on passenger cars is not deductible (except where used in commercial activities, such as car rental). An entrepreneur’s family expenses are not considered part of his business activities, nor are the costs of advertisement of all kinds of alcoholic beverages or tobacco.

Taxable persons without registered offices or residence, management board, subsidiary or any another form of business unit, on the territory of Turkey, not involved in the supply of goods and services, are entitled to tax refunds. The right is however limited to foreign national taxable persons participating in trade fairs and transporting activities in Turkey and is exercised only for the supply of prescribed goods and services provided that it is on a reciprocal basis. In addition to full reverse charge (refund), Turkey also applies a partial reverse charge. This is a temporary measure meant to obtain tax security. The objective is to prevent tax evasion.

The current Turkish Law on ***Excise Duties*** (No. 4760) came into force on 1 August 2002. Turkey stated that this piece of legislation aims to simplify the earlier indirect tax system and to harmonise with EU standards. In addition, implementing legislation consists of Cabinet Decrees, Communiqués, and Circulars.

Excise duties are collected once at one single stage in the consumption process. Goods within the scope include energy products (List I), vehicles (List II), alcoholic beverages and tobacco products (List III), and other consumption goods (List IV).

The tax liability incurs at the actual moment of delivery, import, or first acquisition. Delivery is defined as the transfer by the owner (or those acting on his behalf) to the recipient (or those acting on his behalf) of the right of disposition of property. Consignment of goods or commencement of transport is also considered 'delivery'. Products utilised, consumed, dispensed to employees as wages, bonus, or gifts are equally considered 'delivery'. Vehicles (List II) are only considered delivered at first acquisition. Import is defined as entry of goods subject to excise duty into the Customs Territory of the Republic of Turkey.

Excise duties are assessed and collected upon written declaration of tax payers. Persons involved in the transactions are responsible for the payment of the duty. The Customs Administration is responsible for calculating excise duties on imports; these are paid at the same time with any import duties.

Diplomatic personnel (on a reciprocal basis) and international organisations are exempted. Goods in List IV, such as caviar, fur, white goods and electrical household machines, are not subject to diplomatic exemptions. Following provisions of the Customs Law (No 4458), goods are exempted when subject to a transit procedure, a customs warehouse procedure, an inward processing procedure, a processing under customs control procedure, in free zones, or temporary storage areas. Turkey does not apply a national system of warehouse keepers and tax warehouses, allowing producing or storing under excise duty suspension. Exports are exempted by firstly deferring payments and secondly cancelling payment of excise duties when goods are delivered within three months. The Ministry of Finance is authorised to determine the principles and procedures for exemptions and the application of deferment and cancellation.

Turkey's free zones are governed by Free Zones Law (No 3218). The Undersecretariat for Foreign Trade issues operating licences. Any kind of industrial, commercial or service activities, determined by the High Planning Council, can be carried out within the free zones. On 6 February 2004 Law 5084 came into effect, making free zone users tax-payers. However, the profits of the personal and corporate income taxpayers having taken out their licence by the date of 06.02.2004, and having conducted business in these zones, are exempt from Personal and Corporate Income Tax until the expiration date of the existing Operation License. The users that received a licence before that date shall be exempted from all taxes, levies and duties generated on their transactions related to their free zone operations until 31 December 2008. Turkey informed that only the profits earned from the sales of goods produced in free zones, under operating licences on production, are exempt from income tax until the end of taxable period in which Turkey becomes a full-member of the EU. Profits from the sale of goods produced outside the free zones are not exempted from income and profit taxes.

Turkey does not have a separate free zone banking practice. The financial services in the free zones can serve both free zone users and residents, however only free zone users who obtained an operating licence before 6 February 2004 can benefit from the tax exemption on banking transactions. Their activities fall within the supervisory activity of the Banking Regulation and Supervision Agency, the Undersecretariat of Foreign Trade.

The Council of Ministers has the authority to adjust the rates. Turkey does not apply a system of fiscal stamps to alcohol and alcoholic beverages, nor is this applied to manufactured tobacco products. However, the Ministry of Finance is authorised to collect duty through banderol application for alcoholic beverages. This is mainly used for food security reasons.

Following the Custom Union Decision, Turkey has terminated the state monopoly in the production and trading of tobacco products and alcoholic beverages. A separate regulatory authority was created establishing the Tobacco, Tobacco Products and Alcoholic Beverages Market Regulation Authority (TAPDK). Its president and board are appointed by the Council of Ministers. The TAPDK is independent in fulfilling its duties and has financial and administrative autonomy. Its responsibilities are related to providing and enforcing implementing regulations, monitoring and surveillance for sales and production.

Turkey's legislation as regards *alcoholic beverages* is based on the Law on Excise Duty (No 4760) as well as related implementing regulations. It contains 18 CN codes (Table A of List III) under which alcoholic beverages are placed. Specific taxes are levied divided in three categories. An amount of 0.2380 NTL for one litre of beer is multiplied by the strength of the alcohol in percentage points. For wines and beverages with an alcohol strength of 18 percentage points or less, an amount between 3.28 and 15.6 NTL is calculated per litre. A third category concerns generally the stronger spirits. Here duty is calculated by multiplying an amount between 35.84 NTL (for raki) and 70.92 NTL per litre by the alcohol level in percentage points. Proportional taxation is applied in the excise system for alcoholic beverages provided that the calculated tax is not less than the tax calculated according to the minimum specific tax amount. Proportional tax is applied on beer and fresh grape wines at the rate of 63.3%; on other alcoholic beverages at the rate 275.6%. Minimum specific tax amounts mentioned above are also threshold. Denatured alcohol is not subject to excise duty; neither is pure ethyl alcohol. Non-alcoholic beverages, except cola soda-pop, are not covered by excise duty.

Turkey is aware that its excise duty structure results in a discriminatory practice. Whilst excise tax is equally levied for alcohol beverages at 275.6%, minimum tax yields are substantially higher on those spirits, for example whiskies, imported from the EU, compared to other spirits, such as raki, which are primarily produced locally. Turkey stated its intention to eliminate the discriminating effects between the some spirits gradually.

*Tobacco products'* legislation is based upon the Law of Excise Duty. List III (Table B) contains tobacco products listed according to their CN codes. Leaf tobacco is not subject to excise duty. However products obtained from leaf tobacco are subject to excise duty. Turkey obliges rolling tobacco to be sold with cigarette paper in an attempt to combat possible illegal trade in tobacco. Cigarettes are taxed per piece at 0.060 NTL (threshold). Other tobacco products (cigars, cigarillos, smoking tobacco, chewing tobacco and snuff) are taxed at 0.060 NTL per 1 gram (threshold). The proportional tax rate is 58% of the retail sales price. However, the duty shall not fall below the mentioned minimum specific tax amount.

The Council of Ministers has imposed a "tobacco fund" (Law No 3291) on imported foreign tobaccos and foreign tobaccos used for domestically produced and blended tobaccos. Turkey explained that the fund is to aid the local tobacco sector, whilst the growers do not receive subsidies. Turkey stated that during the accession process this is to be brought in line with *acquis*.

### II.b. Direct Taxation

Turkey adopted a new Corporate Income Tax Law (No 5520) in 2006. It became applicable as of 1 January 2006. As regards tax on profits, it is the main piece of legislation. The new law is intended to create a corporate tax environment that is more responsive to the increasingly international character of the economy. Turkey has, for example, included rules on 'transfer pricing' and thin capitalisation rules have been amended. The intention was to make legislation compatible with EU, as well as OECD, standards of the EU.

Corporations need a registered office or business centre in Turkey to be fully liable to profit tax. These companies are subject to Turkish corporate tax on their worldwide income.

Non-residents are defined as those having neither a registered office nor a centre of business in Turkey. Only income earned or gained from Turkish sources is subject to Turkish profit tax. Such income is defined as business profits derived from a permanent establishment, or a permanent representative, situated in Turkey of such non-resident corporations. Income from Turkish sources also includes gains derived from agricultural business, gains from independent activities, gains from the rental of movable and immovable properties and rights, gains from securities, as well as other gains derived in Turkey.

Turkey has 61 double taxation agreements. Most of these agreements provide for a limitation on withholding taxes. Turkey applies a 30% withholding tax on cash and accrued funds transferred to corporations or to branches located in countries ('tax heavens') determined by its Council of Ministers.

Turkish tax legislation in the case of corporate restructuring situations is covered by the same Corporate Income Tax Law (No 5520). Provided certain conditions are met, restructuring gains are tax free. The relief is granted in the form of a tax deferral. The conditions generally include full liability (i.e. residency in Turkey for tax purposes), participating entities are corporations, transferring the assets and liabilities at book value, and issuing pro rata shares to the shareholders of transferring companies. Restructuring can be undertaken via a merger, a split-up, a split-off, or the exchange of shares. The tax relief does not cover cross-border restructurings.

Article 18 of the Corporate Income Tax Law states that merging one or more corporations with another corporation, is considered as liquidation for the corporation that dissolves due to the merger. A restructuring operation is a merger if both transferring and receiving corporations are considered as resident for tax purposes (full liability), and if assets and liabilities are transferred exactly and as a whole. Provided certain administrative conditions are met, only profits of the dissolved company, accrued until the date of the merger, are taxed. Gains arising from the merger are not taxed. As regards a division, or 'split up', only the profits of the splitting company, accrued until the date of the split-up, are taxed. Gains arising from the split-up are not taxed. Conditions for a tax free split-up include the requirement that the companies involved are equity companies and fully tax liable. Gains from partial division, or 'split-off', are not taxed. In such a split-off, either participating shares with a minimum holding of two years and fixed assets or a branch of production or service are transferred to another existing or new fully liable corporation. In all transactions, receiving companies are successively liable for the tax debts of the transferring company accrued until and after the division date, though limited to the fair market value of the assets received. Finally, exchange of shares is included in Turkish legislation as a means to restructuring corporations. Gains arising from the exchange of shares are not taxed.

Turkey does not levy withholding taxes on interest from loans, nor from royalty payments made between resident companies. Interest from private bonds, as well as interest from bank deposits and repos, is subject to withholding tax (15%). The situation is the same for associated companies. The payments are treated as deductible expense at the level of the paying company and are taxable at the level of the beneficial owner. A rate of 0% applies to interest on Turkish government bonds and debentures since 1 October 2006. Withholding tax on interest from loans proved by foreign financial institutions is zero since 1985.

Interest and royalty payments to non-resident companies are subject to Turkish withholding taxes. The withholding tax on interest payments to foreign states, international institutions or to foreign companies other than financial institutions is 10%. The withholding rate on interest payments to foreign banks is zero. Withholding tax on interests from bank deposits and repo derived by foreign companies is 15%. The withholding rate on royalty payments to foreign companies is 25 % on the sale of royalties and 22% on the leasing of royalties.

In the area of the Parent-Subsidiary Directive, between resident corporations no withholding tax is levied on the distribution of dividends. Double taxation is avoided by exempting the dividends at the level of the receiving company. There is no minimum holding rate, or holding period, for the shares of the subsidiary's capital. However, dividends distributed from a fully liable corporation to a non-resident parent company are subject to a 10% withholding tax. Also, a 10 % withholding tax is levied on the profit after tax of a permanent establishment of a foreign corporation, when such profit is actually remitted to the foreign head office ('branch profit tax'). Turkey informed that most of its double taxation agreements have ceiling rates for such withholdings. Where cash and accrued funds are transferred to corporations or to branches in low tax jurisdictions ('tax heavens') as determined by its Council of Ministers, Turkey applies a 30% withholding tax.

Double taxation of distributed dividends received from foreign corporations is either eliminated by the exemption method or credit method. The exemption method applies, if the parent has a minimum of 10% in the paid-up capital of the foreign company, if the holding continued for an uninterrupted period of at least on year, and if the gross amount of dividends and/or profits bears a minimum of 15% tax burden on income according to the laws of the country in which the subsidiary operates. Where the main activity is security investments, insurance services or funding including leasing, gains should carry at least the same rate of tax burden with Turkish corporate tax according to the laws of the country in which the subsidiary carries on its business. Branch profits derived from construction, maintenance and assembly works outside Turkey are exempt from tax without any conditions.

Unless profits from a foreign subsidiary or branch are exempt, taxes paid abroad, including corporate tax, can be credited against the corporate tax calculated for such gains in Turkey.

Corporate gains received from the alienation of a foreign participation, with a minimum holding of two years, are exempt provided that these gains are derived by the parent companies of which 75%, or more, of the company's assets, other than net assets, consist of minimum 10% of participation in capital stock of foreign subsidiaries.

The income of individuals (those fully liable for tax purposes), obtained within and outside Turkey, is subject to Personal Income Tax (No. 193). The law defines income, as well as deductible expenses. Income is defined as the total net earnings and profits gained in a calendar year; the source principle is applied. The following are not considered resident in Turkey, even if they stay more than six months: businessmen, scientists, specialists, officials, press and radio correspondents who come to Turkey on a given or temporary mission or for business, and other persons in a similar situation as well as those who come to Turkey for studies, medical treatment, rest and travel. Individuals not resident in Turkey are taxed only on the income and revenues obtained in Turkey.

Turkey applies a withholding tax of 15% on interest payments made to individuals resident in EU Member States. Double taxation on interest is eliminated using the credit method. In this context, interest is defined as income from debt claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits. Income from government securities and income from bonds or debentures, including premiums and prizes attached to such securities, bonds or debentures, is also considered interest.

Income obtained from the sale of securities listed on the Istanbul Stock Exchange, and held for more than one year, are exempt. Income from the sale of participation certificates of investment funds which include at least 51% securities listed on the Istanbul Stock Exchange, and held for more than one year, is exempt, as well as the sale-repurchase of securities that are issued by the Treasury abroad, the earnings yield at their redemption and the periodical earnings of those. The interest from inter-bank deposits and money belonging to financial intermediaries invested in money markets are also exempt from withholding taxes.

Turkey confirmed that it does not intend to introduce any harmful tax measures and that it will adopt the principles of the *Code of Conduct* as a whole. Turkey has not delegated discretionary powers to local tax authorities on changing tax rates. Imposing, abolishing, and introducing exemptions require legislation by the Parliament. Turkey stated that its legislation does not include a legal base to allow for the creation of individually negotiated tax holidays at company level. A range of public institutions is exempted from corporate tax. These include establishments operated by public institutions and enterprises for social purposes, or to protect general human and animal health (such as schools, hospitals, libraries, home for the elderly, boarding home for animals, sport clubs, etc.). Exhibitions, fairs and shows organised with permission of authorized administrative bodies, are exempt. Water supply facilities, municipal transport companies, slaughter houses, public baths and laundries, agricultural enterprises of village unions, are some examples of institutions exempted.

Other exemptions on profit tax are the following: (i) gains derived by international holding companies from the sale of shares in foreign subsidiaries; (ii) gains of joint stock companies obtained from issuing shares above the nominal value; (iii) gains of mutual funds and trust companies, real-estate investment, venture capital, pension, or housing funds and trusts, provided they are established in Turkey; (iv) revenues derived from the transfer of immovables, participation shares, founders' shares, bonus shares and pre-emptive rights owned by corporations under legal prosecution due to their debts to banks or those that are in a debtor position against the Savings Deposit Insurance Fund as well as their guarantors, to be credited from such debts to these banks or the Fund or; (v) 75% of gains derived from the sale for such assets which the banks acquired by these means; (vi) profits from construction, maintenance and assembly works outside Turkey, as well as returns from cooperatives.

Turkey's free zones are in general not limited in the scope of activities. Financial services offered in the free zone, however, are limited to those activities within the zone.

Turkey applies a research and development allowance. Regardless of being resident or non-resident, all individual and corporate income taxpayers can benefit from a credit against the tax base of 40% of R&D expenditures.

In the area of sports, Turkey allows tax credits for 100% of sponsorship expenses for amateur sports and 50% for professional sports. Donations to public institutions, such as institutions engaged in scientific research, are also allowed a full tax credit provided that the deducted amount does not exceed 5% of the annual income of the corporation. Further tax credits are granted for expenses incurred to construct such buildings as schools, health centres and children's' nurseries.

As regards shipping, earnings arising from operating and transferring of ships and yachts, registered in the Turkish International Ship Registry, are exempted from excise duties, personal and corporate income tax. Contracts of buying and selling, mortgage, registration, credit and freight related to ships and yachts to be registered into the Turkish International Ship Registry are exempted from stamp duty, fees, banking and insurance transaction tax and duties. Wages of staff working on ships and yachts registered in the Turkish National Ship Registry are exempted from income tax and duties.

Until 31 December 2013, Turkey's law on Technology Development Zones (No. 4691) provides for exemptions of income and corporate taxes for software and R&D activities carried out in determined zones. Wages for researchers, programmers and R&D staff employed in these zones are exempt from personal income tax until that date. Furthermore, earnings derived by Administrator Companies of Technology Development Zones within the scope of this law are exempt from income and corporate tax.

To promote employment in underdeveloped regions, Turkey applies, until 31 December 2008, a law concerning Incentives on Investment and Employment (No. 5084) in provinces where GDP per capita is below USD 1500, or the socio-economic development index is negative. Depending on whether the enterprise is established in an Organized Industrial Zone, 80% or 100 % of wages paid to the workers employed by the enterprises in these provinces are exempted from income tax, provided that a minimum of 30 workers are employed within the business

Companies are allowed to deduct a range of expenses from the income. Examples include medical expenses, pension contributions, expenses on leased vehicles, travel and accommodation expenses, employers contributions to trade unions, or donations to relief the poor. The Ministry of Finance has a discretionary power to apply the Extraordinary Depreciation Law in situations of a natural disaster, over-wear due to forced performance, or obsoleteness due to new inventions.

### II.c. Administrative co-operation and mutual assistance

Information exchange between the Turkish administration and third countries takes place within the framework of Double Taxation Agreements. A permanent structure for information exchange is not established.

Turkey has no legislation on the exchange of information with EU Members States on interest payments, excluding double taxation agreements. It is preparing to include the possibility of exchange of information on the largest number of taxes in existing and future double taxation agreements following the OECD model agreement. Such exchange of information is provided on request.

Turkey has anti-fraud legislation included in the Tax Procedure Law. In addition, the revised Corporate Tax Law includes provisions against tax evasion. Turkey informed that it investigates the motivation for actions of taxable persons: whether they act for commercial reasons, or tax evasion purposes. As regards the fight against money laundering, Turkish legislation proscribes that payments above 8000 NTL (approx. 4848 €) are transferred through the banking system. This requirement is intended to tighten the cash economy, control payments, and monitor financial and commercial transactions. In addition, the law on Prevention of Money Laundering (No: 4208) applies.

### II. d. Operational capacity and computerisation

With the completion of the Tax Office Automation Project (VEDOP) in May 2006, all tax offices (448) are computerised. Turkey is in the process of preparing the first steps to introduce IT for interconnection with Community systems, as well as a duty suspension mechanism.

Turkey’s current system of e-declaration of VAT is based on non-compulsory compliance. A paper based process is transposed into an electronic environment that will reach 90% coverage in 2007. Turkey indicated that it may consider changing the reporting requirement to a monthly, in stead of a quarterly, basis.

## III. ASSESSMENT OF THE DEGREE OF ALIGNMENT AND IMPLEMENTING CAPACITY

The overall structure of tax legislation is similar to the EU standards. Turkey has reached a satisfactory level of alignment at this stage of the negotiations, with the notable exception of the discriminatory elements of the taxation of alcohol and tobacco products. Overall, the alignment is incomplete, particularly as regards the scope and rates of VAT, the structure and rates of excise duties, as well as direct taxation in general.

The administrative capacity, which is at a reasonably good level, is expected to improve with the new Revenue Administration, a semi-autonomous institution attached to the Ministry of Finance, becoming operational. In addition, hierarchical layers are being reduced to further improve accountability of the local tax offices to headquarters. Policy making at the Ministry of Finance passed to a newly created directorate-general for tax policy, which will need to have direct access to the tax data base. The coordination of tax audit requires further attention.

### III.a. Indirect Taxation

Turkey has partially aligned its legislation in the field of ***Value Added Tax***. Its VAT system follows the main structure of the legislation of the EU. However, there are a large number of differences of a structural nature, including deductions, exemptions, special schemes, tax refunds and the application of reduced rates.

Turkey applies one standard rate (18%) and two reduced rates (8% and 1%). The usage of a reduced rate of 1% is not in line with the *acquis*, nor is the scope to which the reduced rates are applied. This includes the reduced rate of 8% introduced by Turkey for textile products, which is not allowed under the *acquis*. To apply a separate rate for supplies prior to the retail stage is not permitted under the *acquis*.

Turkey uses different definitions such as 'tax payer', 'taxable person', or ‘person liable' for payment of VAT. These definitions need streamlining to be in line with the *acquis*. The same goes for for Turkey's definition of what is considered as an economic activity for the purposes of VAT. In addition, the *acquis* uses the concept of 'place of supply' of goods or services, which is different from the concept of 'place of delivery'. Furthermore, Turkey's legislation is unclear in the distinction made between 'tax-base' and 'taxable amount'. Turkey should also bring its legislation relating to partial exemptions for small enterprises in line with the *acquis*.

Turkey applies a Special Communication Tax, calculated on the turnover of mobile phone companies. This form of value added tax does not infringe the *acquis*, because it is limited in scope and not applicable to all economic transactions.

As regards ***excise duties***, Turkey works with a notion of delivery on paper, whereas the *acquis* uses the notion of the physical leaving of goods from a warehouse.

With regard to *alcoholic beverages*, Turkey applies an ad valorem duty, which is to be replaced by a fixed tax amount, in the case the ad valorem duty results in taxation below this fixed amount. The EU only applies specific duties. Also, the definitions of the products are not in line with the *acquis*. Furthermore, for certain categories of alcoholic drinks, duties are based on the type of product, instead of on the alcoholic content. In addition, all beverages containing alcohol, regardless of strength, are subject to excise duty. On the other hand, pure ethyl alcohol is not taxed at all. This is not in line with the *acquis*, which stipulates a *de minimis* strength of 0.5% for the taxation of beer and 1.2% for other beverages. It provides no basis for exempting pure ethyl alcohol except in certain circumstances, e.g. denatured alcohol. Furthermore, the rates applied result in higher taxation on those spirits which are mainly imported and lower taxation on products that are usually produced inside the country. This policy represents a breach of the Customs Union (Art. 50 of Decision 1/95).

With regard to *tobacco products*, Turkey defines the cigarettes on the basis of the CN code, which is not in line with the *acquis*. In addition, an ad valorem rate of 58% of retail selling price, in combination with minimum excise levels, is applied. The minimum excises levels are not established with reference to the Most Popular Price Category. This structure is not in line with the *acquis*. Turkey needs to levy a specific duty (between 5 and 55% of the total) in addition to the ad valorem element. The combination of the two elements must reach at least 57% of the retail selling price, as well as a minimum of 64€ including VAT, per 1,000 cigarettes.

As concerns fine-cut tobacco, Turkey applies an ad valorem duty of 58%, in combination with a minimum duty of 0.036€ per gram. Definitions, excise structure and rates are in line with the *acquis*. With regard to other tobacco products (cigars, cigarillos, other smoking tobaccos), the structures and the rates applied are in line with the *acquis*. However, Turkey uses definitions that are not in conformity with the *acquis*.

Moreover, Turkey applies a specific duty on imported tobacco and cigarettes, which finances a "tobacco fund". The application of this specific duty only to imported products is not in line with the *acquis* and represents a breach of the Customs Union (Art. 50 of Decision 95/1).

With regard to *energy products*, alignment is at an early stage.

Turkey applies the duty on fewer products since it does not apply an excise duty on electricity, coal and coke. It is therefore clear that the scope of the Turkish legislation on energy products needs to be enlarged to include these products as well. Moreover, Turkey does not distinguish taxation on the basis of the final use of the product (e.g. heating, motor, etc.). Turkey applies an Electricity Consumption Tax to the sale of electricity, with two different rates depending on the final use of the product. The purpose definitions provided for in Directives 92/12 and 2003/96 need to be taken into account. Currently energy products are defined in an unclear manner using terminology such as "mineral oil", "petroleum products", "solvents", etc., which is not in line with the definitions of the acquis.

The level of duty applied by Turkey on motor oils, diesel and gas seems to be in line with the requirements of Directive 2003/96. However, this is not easy to establish as the units used are not in all cases those used in Directive 2003/96/EC. Moreover, the Council of Ministers is authorised to either increase the highest duty rate by 50% or to decrease it down to zero. This may imply that no real minimum rate of taxation is currently applied. Finally, the Turkish legislation provides for a number of exemptions and reduced duty rate applications, some of which may be not in line with the provisions of Directive 2003/96/EC.

Turkey levies excise duties on motor vehicles, flying vehicles, certain non-alcoholic drinks, household appliances and some luxury products, which the *acquis* does not prescribe. However, neither does the *acquis* prevent levying these excise duties provided that this does not give rise to barriers to the free circulation of products within the EU or to systematic border controls. Additionally, in the area of taxation of second-hand vehicles, it is not clear whether the evaluation of the residual value of imported vehicles would result in higher taxation compared to similar ones produced in Turkey.

Turkey has not yet introduced a duty-suspension regime for domestic movements and fiscal warehouses.

**III.b. Direct Taxation**

As regards corporation tax, the overall level of alignment is limited. The Turkish revised Corporate Tax Law, which entered into force on 1 January 2006, is modelled on the *acquis*. It ensures that no tax is levied at the time of execution of the transactions covered by the Merger Directive for domestic operations. However, the Turkish rules only apply to domestic situations and therefore need to be extended to cross-border transitions with Member States as provided by the *acquis*.

With regard to the Parent-Subsidiary Directive, alignment is advanced.

Turkey will need to widen the scope of the legislation to include mutual insurance companies. The minimum tax burden of 15% is problematic since several Member States apply lower corporate income tax rates. Uniformity of the implementation of the several directives needs to be ensured.

Upon accession at the latest, Turkey should have transposed the Interest and Royalties Directive and have eliminated its withholding taxes on interest and royalties payments. As regards taxation on the raising of capital by companies (Capital Duty Directive), Turkey abolished in 2004 such a duty and thus is in line with the *acquis* in this area.

As regards the *Code of Conduct*, Turkey's indication not to introduce new harmful tax is in line with the *acquis* requirement. Preparations for the adoption of the Code of Conduct require a further in-depth analysis on potentially existing harmful measures in Turkey.

With regard to taxation of individuals, Turkey will need to transpose Council Directive 2003/48/EC (the Savings Directive) to apply by the time of accession a mechanism of cooperation between Member States, such as the exchange information on interest payments to individuals with all the Member States, as well as with the 9 dependent and associated territories that have requested reciprocity (for 7 of them reciprocity is already applicable - Aruba, British Virgin Islands, Montserrat, the Netherlands Antilles, Jersey, Guernsey and Isle of Man -; 2 additional territories - Anguilla and Turks and Caicos – will be entitled to reciprocity when they introduce direct taxation within their jurisdiction). Precise definitions in the *acquis* need to be adopted.

Should the transitional period of the Savings Directive not have expired before Turkey's accession, Turkey will have to -upon accession- grant full credit for the withholding tax levied on interest payments made to its residents in Austria, Belgium and Luxembourg (as well as in 6 of the above mentioned dependent territories and in the 5 non-EU European countries having agreed equivalent measures with the Community -Switzerland, Liechtenstein, Andorra, Monaco and San Marino). In this context, Turkey will in any case have to:

- Examine if the Annex to the Savings Directive has to be completed as far as Turkish entities are concerned;
- Conclude bilateral agreements for the same measures as those of the Directive with the 10 dependent or associated territories (those mentioned above plus the Cayman islands), in accordance with the models agreed by Member States meeting within the EU Council to this purpose;
- Confirm to Switzerland, Liechtenstein, Andorra, and San Marino the political commitments taken by Member States within the Memorandums of Understanding joined to the Community agreements on taxation on savings with these non-EU European countries;
- Apply the provisions of Article 15 of the agreement on taxation of savings between the Community and Switzerland as far as dividends, interest and royalties payments between associated companies are concerned; and
- Communicate its competent authorities for the application of the Agreements with Switzerland, Liechtenstein, Monaco, Andorra and San Marino.

### III.c. Administrative co-operation and mutual assistance

Bilateral cooperation is established with a number of Member States to circumvent tax evasion and tax avoidance. Administrative cooperation in the fight against fraud in the field of direct taxation is established through bilateral treaties on the prevention of double taxation. This provides a degree of preparedness for alignment. Turkey does not have any legislation regarding the *acquis* on mutual assistance and administration.

### III. d. Operational capacity and computerisation

Turkey is sufficiently aware of the necessity to prepare interconnectivity and interoperability with the physical tax infrastructure of EU Member States though parallel planning of related legislation. Turkey should start the planning and development of EU compatible IT systems and adapt its existing tax related IT infrastructure, in order to allow the exchange of computerised data between the EU and the Tax Administration upon accession.

As regards computerisation in the field of VAT, Turkey will need to prepare for the development of the IT systems allowing interoperability and interconnectivity with the EU systems. Turkey should also ensure that the exchange of the information among Member States related to the special scheme for e-Services provided by non-EU traders to EU citizens, is in place and inter-connected with EU systems.

Regarding excise duties, Turkey should start preparing for an infrastructure that allows physical interoperability and interconnectivity with the EU systems. This should allow Member States to exchange information on producers and traders of excisable products (SEED, EMCS, MVS, EWSE). The use of a Common Communication Network (both

Common Communication Network mail and Common System Interface mail) will need to be integrated in the infrastructure of the Tax and Customs Administrations.

In the area of direct taxation, Turkey will have to prepare an IT system allowing the exchange of information on income received by non-residents on savings products.

Turkey will also need to prepare for exchange of all other forms in the taxation domain.