

Indirect Tax Newsletter

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TAX

Welcome to this new issue of our Indirect Tax Newsletter. It aims to provide our readers with an overview of key indirect tax developments from both Turkey and the European Union. This issue comes back to the risk of double taxation related to implementation of the VAT reform known as the “VAT Package” in the European Union. In Turkey, a new online application should simplify the VAT refund process. We also discuss a VAT recovery issue specific to the tourism sector and some latest developments related to Special Consumption Tax.

European businesses receiving services from Turkish suppliers might face a risk of double taxation

In the previous issue of this newsletter, we described some of the key features of the VAT reform known as the VAT Package, which entered into force on 1st January 2010 in the European Union. We highlighted some potential double taxation issues triggered by the generalization of the taxation of services supplied cross-border in the country where the recipient (business) is established. From a Turkish VAT point of view, these services would be seen as benefited and hence taxed in Turkey.

In other words, a supply of services could be both subject to Turkish VAT according to Turkish VAT rule (not recoverable for the foreign recipient) and to reverse-charged VAT in the country of the recipient (potentially recoverable).

In addition to this dual VAT charge, the recipient is facing an additional risk: some member states consider that the Turkish VAT charged is part of the taxable basis on which local VAT should be applied.

The issue

According to the definition of the taxable basis provided by the European VAT Directive “taxes, duties, levies and charges, excluding the VAT itself shall be included in the taxable amount”.

Whereas Turkish VAT could be regarded as excluded from the taxable basis at first sight, it appears that some tax authorities consider that only VAT charged in an other European member state should be excluded, whereas VAT charged outside the European Union is included.

The following approach is notably followed by Bulgaria, the Czech Republic, Denmark, Finland, Malta, Romania and Slovakia. Some other member states have not issued any clear guidance in this respect but the same risk could materialize in Germany and in the Netherlands.

Next steps?

Turkish businesses supplying services to EU-based clients with limited VAT recovery right (e.g. banks or insurance companies) should review their contractual arrangements to find out which



party is supposed to bear the VAT costs, especially if the clients are established in some of the member states where local VAT is due on the service fees including Turkish VAT.

European partly-exempt businesses receiving services from Turkey should reach out to their tax authorities or their advisers to clarify the official position.

Latest news: Greece increased its VAT rates as part of new fiscal measures taken to cope with the financial crisis

The Greek government increased the VAT rates applicable both in mainland Greece and in the Aegean islands as part of a package of measures taken to answer the financial turmoil faced by the country.

Effective from 15 March 2010 the VAT are the following:

- normal rate: increased from 19% to 21%,
- reduced rate: increased from 9% to 10%,
- super-reduced rate: increased from 4.5% to 5%.

The new VAT rates applicable to Aegean islands are determined as follows:

- normal rate: increased from 13% to 15%,
- reduced rate: increased from 6% to 7%,
- super reduced rate: increased from 3% to 4%.

VAT refund procedure enters the electronic era

The delay taken by the tax authorities to conduct and approve VAT refund request has been discussed for years. The Circular issued by the Ministry of Finance on 27 January.

Introducing the “VAT Refund Risk Project” might offer a solution. This circular introduces an online VAT refund process applicable from 1st January 2010 on request to related VAT incurred from that date on. The VAT refund summary report as well as the documents on which it is based, will be submitted to tax office electronically.

The new regulation is expected to reduce the time-consuming manual controls, formalities and bureaucracy, and to accelerate the VAT refund process by providing a standard and harmonized procedure to all tax offices.

Based on this model;

- Taxpayers will no longer submit the documents needed for VAT refund on paper or on CD to the tax office. On the contrary, these documents will be transferred to the online system run by Revenue Administration.
 - Almost all the human handling and manual reviews, which are performed by tax offices from VEDOP (Tax Office Automation Project) system, will be done by using computer technology. Therefore, the workload, and hence the time need for the processing of VAT refund requests should be reduced.
 - The new online procedure should allow the tax authorities to identify efficiently more fake invoices recorded or issued by taxpayers.
- On 19 February, the Ministry of Finance released some additional explanations on the new procedure:
- According to the new regulation; “the breakdown of input VAT”, “the breakdown of incurred VAT subject to VAT refund”, “the list of sales invoices” and “the customs (outgoing) declarations” (if they are requested for VAT refund) will be sent in electronically.
 - Any other documents related to VAT refund, that are not listed above should be sent to tax office as before.

- Hard copies of the above-mentioned breakdowns submitted electronically should not be sent to tax office
- The taxpayers' VAT refund requests will be validated once all documents are submitted to the tax office.
- The tax offices will evaluate the VAT refund process based on "VAT Refund Control Report" and other documents generated by the system. Then the VAT refund process will be completed in accordance with the principles governed by the related VAT Communiqués.
- Purchases from the same seller will have to be entered into the system on document-by-document basis.
- Total amount of cash register receipt and retail sales vouchers can be entered online into the list of input VAT. However, the amount entered should not exceed %5 of the total input VAT.
- All taxpayers are subject to the new regulation.

Scope of the new procedure

The new procedure covers the following kind of VAT refund requests: refund of irrelevant and overpaid taxes according to the article 8/2) of VAT Code, withholding VAT applications according to the article 9/1), VAT refund related to reduced rate transactions according to the article 29/2), and the VAT refund related to VAT exempt transactions according to the article 32.

Potential Issue

Although this new procedure should be generally welcome by businesses, some manufacturers might face some issues to produce the breakdowns of the VAT amounts subject to the request for refund, which should be submitted online from the existing accounting programs. Indeed these

programs are usually cost-based and might not be capable to generate the relevant information needed. Unless the system is amended, it could be more convenient to submit the calculation table of the amount of VAT subject to VAT refund as done before the system was introduced.

Businesses in the tourism sector might face some issues to get refund of VAT paid on purchase of fixed assets

The VAT credit and refund mechanism is ruled by article 29/2 of the VAT Law. Accordingly, input VAT that can not be offset by taxpayer against its own VAT liabilities, because their supplies are subject to a reduced VAT rate, is offset against other tax liabilities within the current year. The VAT refund can be made in cash or used to be offset other tax liabilities in the following years.

Although this specific VAT refund mechanism is normally applicable to the VAT incurred on purchases directly used for the supplies subject to reduced rates, taxpayers are also allowed to apportion a part of the VAT incurred on purchase of fixed assets and overheads not directly attributable to supplies subject to reduced rate and subject this proportion to the VAT refund process.

Based on the authority given to the Council of Ministers to amend this system, it was decided that taxpayers operating hotels, resorts, holiday villages etc. should not be allowed to get a refund of part VAT incurred on fixed assets based on this ratio.

Further to the entry into force of this regulation (on 20 July 2008) that seriously affected the tourism sector, some taxpayers claimed that this provision was discriminatory and anti-constitutional and brought the case to the Supreme Court.

On 21st October 2009, the Supreme Court has decided to cancel the regulation while referring the case to the Constitutional Court.

Supreme Court has stated that the application of the regulation will be canceled temporarily until a decision is taken by the Constitutional Court and definitely if no decision is taken within 5 months.

If the Constitutional Court confirms that the provision is anti-constitutional there will be no possibility to execute the Council of Ministers' decision.





Consequently, tourism enterprises should carefully monitor the outcome of the court case since the decision to cancel the regulation or not might have important cash-flow impacts for businesses from the tourism industry.

The Special Consumption Tax (SCT) rate applicable on pick-up type cars has been clarified

On 6 February 2010, some pick-up type vehicles have been classified as passenger cars according to a new customs regulation related to changes on the harmonized tariff system.

The qualification of some pick-up vehicles as passenger cars generated some doubts regarding the determination of SCT rate applicable. Indeed, the determination of SCT rate applicable is based on the harmonized tariff system. Consequently this new classification could change the SCT rate applied on the pick-up vehicles, which would increase from 4% up to 84%.

Fortunately the situation was clarified by a SCT circular issued by the Ministry of Finance, which states that the changes made in harmonized tariff system will not affect the application of SCT on goods listed in the SCT Code, unless the change is regulated by a law passed by the Parliament or by a decision of Council of Ministers. The automobile dealers and lovers of this kind of cars should feel relieved by this decision.

Special Consumption Tax rate applicable on LPG used for the production of aerosol is reduced to 0 %

According to a decision of Council of Ministers on 5 February 2010, the "Liquid Petroleum Gas" used as a raw material in aerosol, is subject to 0% SCT. Supplies of LPG for other purposes is subject to the rate of 1,21 TL/kg.

The aim of this regulation is to help local producers to face the competition from countries such as China and Argentina that especially produces perfume, deodorants, sprays or shaving gels.

The zero-rating applied on supplies of LPG is governed by the 18th Communiqué of Special Consumption Tax Code. According to this Communiqué, zero-rated supplies will be applicable only for the LPG which is "standardized and suitable for aerosol production". Standardized LPG will be recognized by "ODTÜ Petroleum Research Center Ankara Laboratory".

Moreover, only the producers who have obtained the "LPG Purchase License" will be able to buy/import this kind of LPG.

Zero-rated supplies of LPG can only be made by licensed distributors.

Distributors will need to take a copy of "LPG Purchase License" from producers. Distributors will declare the LPG they delivered free of SCT separately in their SCT returns. The guarantee given to the Customs by the distributors will be released after the tax office has sent a notice to the customs administration based on the SCT return.

If distributors have purchased LPG from local refineries, they will deduct the SCT they paid from the SCT charged on their own supplies.

Producers who have Inward Processing Certificate can also directly import the LPG for aerosol production free of SCT. In order to do this, the producers have to be registered as a SCT-payer with their tax office by the date of the import date as the latest.

If the imported LPG is used for both aerosol production (with or without SCT), Sworn Tax Advisors will prepare a "Production Report" for a 6-month period to prove that the zero-rated LPG has been used in the aerosol production process.

This new regulation should be seen as a significant incentive for the aerosol producers that use LPG as a major raw material.

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