

Indirect Tax Newsletter

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TAX

Welcome to the 1st 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 outlines the potential effects for Turkish businesses of one of the changes brought by the VAT reform known as the "VAT Package" in the European Union and comes back to the recent abolishment of the tobacco fund and related increase of Special Consumption Tax ("SCT") on tobacco products, the amendments of conditions to exempt export of services or supplies to diplomatic agents and the restriction of the deduction of VAT incurred for the production of some perishable goods.

VAT in the EU: One of the most important VAT reforms of the last years in the European Union may have impacts for businesses in Turkey

Background

1 January 2010 saw the introduction of the 'VAT Package', a bundle of legislative changes which notably affect the time and place of supply of services for VAT purposes. One of the main consequences of this reform is the change of the main place of supply rule for supply of services made to other businesses ("B2B" supplies). Whereas the basic rule had been that services were taxed where the supplier was established, this place of taxation is now changed to the place where the customer is established.

Services recipients are liable to self-account for VAT on overseas services according to the date these were performed. This change of rule is in line with one of the general principle underlying the VAT as a concept: VAT should be levied in the country where the consumption takes place. This explains why some exceptions will remain applicable, for example for services related to an immovable property which will be taxed in the country where the property is located.

Whereas cross-border B2B supplies of services within the European Union should not be subject to double taxation since the same set of rules will be applied in the 27 Member States, the situation could be different when one of the suppliers is established outside the European Union.

Potential issues

According to Turkish VAT law, the "export" of services, i.e the supply of services to a recipient who is not established in Turkey can also be VAT exempt provided that some conditions are fulfilled. One of the major conditions is that the services should be "consumed" outside Turkey.

The nature of the services itself or the status of the recipient (business of private individual) is not relevant. It all comes back to the concept of "consumption" in Turkey, which serves as safety net powerful enough to keep a lot of supplies within the scope of the Turkish VAT.



The change of the main place of supply rule to the place where the recipient is established means that most of the services (with a few exception) rendered by Turkish suppliers to business recipients established in the EU will be taxed where the recipient is located, whereas the same supply could also be subject to Turkish VAT according to Turkish legislation.

This double taxation increases the costs of doing business with Turkish companies. Indeed in addition the Turkish VAT burden (18%) not recoverable by the non-resident company, the latter will have to account for the VAT of its country of establishment. Depending on the nature of its activities, this taxpayer may not be fully entitled to recover this accounted VAT, ending up with a double VAT taxation.

This would be the case if the services are rendered to banks of insurance companies. There is also an additional risk some tax authorities consider the Turkish VAT charged as part of the taxable basis on which the recipient should account for local VAT.

Where this kind of issue is not new, the scope of services concerned is now widening to cover almost all range of services possible.

Next steps?

Turkish businesses supplying services to EU-based business customers should determine whether the services rendered can be exempt in Turkey as “exported services” and if these services are covered the new main place of supply rule. If this is the case and especially where their customer is a bank, an insurance company or an entity with limited right to recover VAT, business should review their contractual arrangements to find out which party is supposed to bear the VAT costs in order to reduce the risk to see their margin reduced by the new unrecoverable VAT cost arising for the new place of supply rule.

VAT incurred on outdated and perishable products is no longer deductible

Companies mainly operating in medical and food sectors have been allowed to deduct VAT incurred in connection with goods which became outdated/perished before being sold.

However further to the General VAT Communiqué No 113 dated 5 December 2009, issued by the Ministry of Finance such deduction is no longer possible under Turkish tax law.

This communiqué, states that “... destroyed products regarded as outdated or products which became perishable should be considered as “lost products” as per Article 30/c of VAT Law.” According to Article 30/c of the VAT law; incurred VAT incurred in relation to these lost products cannot be deducted for VAT purposes (except when the lost is due to earthquake, flood or by fire for example).

Our Comments

This new approach followed by the Ministry of Finance that is totally different from the current practice and related rulings covering the concept of “perished product” in tax laws. The term “perished” has been understood by tax authorities in its general meaning and characterized destroyed, devastated or broken goods. Accordingly, in order to determine whether or not goods were perished, tax authorities were assessing the physical situation of the goods rather than the lost of economical value or the fact that they were outdated.

Changing this approach through a communiqué is likely to be a challenge and could create a considerable tax burden for some taxpayers which will be worsened by the retroactive application of the communiqué (applicable retroactively within the legal prescription period).

What should be done?

Taxpayers which have incurred and deducted VAT incurred in relation to products regarded as “perished” under this new interpretation should regularize the initial VAT deduction by increasing the VAT liability in the return of the period where the products were lost.

Past VAT declarations where VAT deduction was asked for should be revised. VAT liability should be declared conditionally under protest while some taxpayers may seek to contest this approach in the court. We believe that this new approach could be open to challenge in the courts since it is was not triggered by an amendment of the legislation

VAT exemption of export of services: abolishment of one of the conditions

According to article 12/2 of the VAT law, considering a supply of services as a VAT exempt export required some conditions to be met.

According to the relevant General VAT communiqué No: 26; the following four conditions should be met to treat supplies of services as exported (and hence VAT exempt);

- the services must be performed for a customer who is resident abroad (outside of Turkey),
- invoices and other documents must be issued in the name of the foreign customer,
- fee of the services must be brought into Turkey as a foreign currency; and,
- services must be benefited/utilized abroad.

In its General VAT Communiqué No: 113 of 5 December, the Ministry of Finance stated that export of services could be regarded as exempt without having the fees brought into Turkey. However, the VAT incurred by the supplier in relation to these transactions cannot be refunded without the transfer of the fees to Turkey”.

Tobacco Fund duties on Imported Tobacco are abolished

As of 1 January 2010 the special duty collected by the Tobacco Fund on imported tobacco and cigarettes was brought to zero.





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Duties levied on imported tobacco and tobacco products, cigarettes and cigars have been reduced to zero by a decision of the council of ministers. Some tobacco products such as tobacco leaves covered by customs classification 24,01 will still remain subject to the special duties.

Moreover, where there raw material used to produce tobacco are imported, such materials will be subject to the duties collected by the Tobacco Fund.

This regulation has come to life as a part of the Turkey's EU accession process. The "Tax Chapter" of the accession negotiation between Turkey and EU opened on 30 June, 2009. The existence of these duties had been criticized as a form of discrimination by the EU in various progress reports.

This amendment of the law can be regarded as an important step in Turkey's accession process. On the other hand, the Special Consumption Tax rate applicable on tobacco products has been increased. The main reason of such a move is the help reducing the current budget deficit caused by financial crisis.

VAT Exemption of supplies to diplomatic and consular agents subject to a new procedure

Some of the rules governing the VAT exemption of supplies to diplomatic agents were changed by a General VAT communiqué on 1st January, 2010.

Previously, the exemption was applied through a bank credit card (VAT exemption card) by provided to qualifying diplomatic representatives of countries which apply similar exemption..

According to the new regulations, the exemption cards are no longer in use. The diplomatic agents will have to pay VAT on their expenses and claim it back within 3 months by submitting a breakdown of their purchases to their representation. The foreign representations will provide these details to the relevant tax offices in the second step. Tax offices will reimburse the VAT amount incurred on the purchases made by each individual by transferring the amounts to their bank accounts, subject to the limits specific to the country and for purchases amounting to minimum 50 TL (invoices for utility services are not subject to this limit).

The suppliers will issue an invoice including the ID number of the foreign agent, his name and surname. This information is not required in the invoices for utility services (i.e. water supply, electricity, telecommunication services).

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