

# Inflation adjustment according to Tax Procedure Law and specified issues

## 1. Introduction

Article 298 of the Tax Procedure Law, titled "Inflation adjustment, revaluation rate and revaluation", constitutes the basis for the inflation adjustment made in accordance with this Law. Inflation adjustment is defined as to calculate in terms of purchasing power on the date of financial statement through multiplying the amounts to be taken into account in the inflation adjustment of non-monetary assets according to subparagraph A/2-c of this Article.

## 2. Inflation adjustment application in terms of 2003 and 2004 accounting periods as a result of regulation made in accordance with Law numbered 5024

The principles regarding inflation adjustment were introduced by amending the provision of Article 298 of the TPL with the Law No. 5024. Accordingly; inflation adjustment for the 2004 accounting period was carried out in accordance with the provisions of TPL repeating Article 298/A. On the other hand, the principles of inflation adjustment to be made as of 31.12.2003 are regulated by the provisional article 25 of the Tax Procedure Law.

In this context, the balance sheet dated 31.12.2003 should be subjected to inflation adjustment and the conditions in the Repeating Article 298 of the TPL as of 01.01.2004 (the increase in D-PPI (domestic producer price index) announced by TURKSTAT for the last three years including the current period) has differed within the scope of the application of inflation adjustment in the following accounting period (31.12.2004) based on the existence of more than 100% in the accounting period and more than 10% in the current accounting period. Therefore;

- In the adjustment of financial statements dated 31.12.2003, Provisional Article 25 of TPL and General Communique of TPL No. 328 should be taken into account while
- Repeating Article 298/A of TPL and General Communique of TPL No. 338 should be considered in the correction of financial statements dated 31.12.2004.

## 3. Inflation adjustment after 31.12.2004

The first period in which the aforementioned conditions that must be met in order for the inflation adjustment to be applied was met after 31.12.2004 was 31.12.2021. As of December 2021, the increase rates in the PPI index are 141.70% for the last three accounting periods (last 36 months) while it was calculated as 79.89% for the current accounting period (last 12-month period). In this context, it has emerged that the balance sheet dated 31.12.2021 should be subject to inflation adjustment in accordance with Article 298 Bis of the Tax Procedure Law.

On the other hand, with the Law No. 7352 published on 29.01.2022, provisional article 33 was added to the TPL and a new principle regarding the inflation adjustment application was adopted. In the following section, this amendment and the resulting implementation principles will be discussed.

#### **4. Implementation subsequent to Law numbered 7352**

According to Law No. 7352 published in the Official Gazette dated 29.01.2022 and the provisional article 33 added to the Tax Procedure Law; financial statements shall not be subject to inflation adjustment regardless of whether requirements for inflation adjustment arises or not in terms of 2021 and 2022 accounting periods, including provisional tax periods (due to accounting periods ending in 2022 and 2023 for those assigned a special accounting period).

On the other hand, financial statements dated 31/12/2023 shall be subject to inflation adjustment regardless whether requirements for inflation adjustment have occurred or not. (The profit/loss difference resulting from the inflation adjustment will be demonstrated in the previous years' profit/loss account; the previous year's profit determined in this way will not be subject to tax, and the previous year's loss will not be accepted as loss.) Again, in accordance with the regulation in provisional article 33, the Ministry of Treasury and Finance is authorized to determine the procedures and principles regarding the implementation of this article.

In the following sections, special issues in inflation adjustment will be focused mainly on the inflation adjustment application in the financial statements dated 31.12.2023, and where appropriate, the correction process in the financial statements dated 31.12.2023; a comparison with the inflation adjustment that will be made in the 2024 accounting period, depending on the existence of the conditions in the Duplicate Article 298/A-1 of the TPL, will be included.

#### **5. General principles in terms of inflation adjustment for financial statements**

How the inflation adjustment to be made in accordance with the TPL can be summarized as follows from the principles in repeating Article 298/A of the TPL.

- Non-monetary assets are determined.
- The date, amount and coefficients to be taken into account in the correction of non-monetary assets are determined.
- Non-monetary assets are adjusted.
- Adjustment transactions are recognized in the "698 Inflation Adjustment" account determined in the Uniform Chart of Accounts against the "Inflation Difference" accounts to be opened for the non-monetary assets subject to adjustment.
- Differences collected in "698 Inflation Adjustment Account" regarding all adjustments are transferred to profit/loss for the period (Retained Year Profit/Loss as of 31.12.2023).

Some of the specific situations in the upcoming period inflation correction (correction of financial statements dated 31.12.2023 and correction of financial statements for periods after 01.01.2024, depending on the existence of the conditions stipulated in Article 298/A of the TPL) will be included in the following sections.

## **6. Specified situations in terms of inflation adjustment**

### **6.1 Financial statements to be subject to adjustment**

It should be noted that in previous practice, the financial statements to be subjected to inflation adjustment, both from the financial statements dated 31.12.2003 and 31.12.2004, were limited to the balance sheet only.

For example, the following requirements has arose taking into account the provisions under article 25 of TPL and explanations included in Serial No:329 General Communiqué on TPL:

- Preparation of the financial statements dated 31.12.2003 without taking into account the inflation adjustment provisions,
- Making inflation adjustments from the financial statements dated 31.12.2003, valid only for the balance sheet, and calculating the tax base for 2003 based on the profits determined according to the financial statements before the adjustment,
- In any case, the balance sheets prepared at the end of the 2003 accounting period should be subject to inflation correction.

Again, in the previous practice, taxpayers who had to make inflation adjustment were required to compulsorily adjust only their balance sheets from their financial statements to be issued after 01.01.2004, in case the adjustment conditions were met.

Although it is anticipated that a similar situation will be valid for inflation adjustment applications in 2024 and the following period, depending on the conditions in 31.12.2023 and Article 298/A of the TPL, it would be appropriate to follow the secondary regulations to be made by the Turkish Revenue Administration on the subject.

### **6.2 Situation of foreign currency shares and participations**

Shares are valued at their purchase price according to Article 279 of the TPL. On the other hand, in accordance with Article 298/A of the Tax Procedure Law, the shares must be corrected by multiplying them with the correction coefficient, whether they are traded on the stock exchange or not.

However, in the application for the adjustment of the balance sheet dated 31.12.2003, a different determination was made on this issue by the Revenue Administration with the TPL Circular No. 9 dated 05.08.2004. In this context, it has been deemed appropriate to correct the foreign currency denominated stocks, participations and advances in the assets of the entities with the exchange rate on the correction date, based on the authority given to the Turkish Revenue Administration in Article 298/A-8 of the TPL.

It is possible to make a similar determination in subjecting the balance sheet dated 31.12.2023 to inflation correction, within the scope of the authority given to the Ministry of Treasury and Finance in accordance with Article 298/A-8 of the TPL. It will be appropriate to follow secondary regulations such as Communiqué, Circular which shall be published by Turkish Revenue Administration.

### **6.3 Aggregated method applications in subjecting inventories to inflation adjustment**

If taxpayers prefer aggregated methods in the inflation correction of stocks, they will perform the correction based on the correction coefficients found according to these aggregated methods, instead of the correction coefficients in the correction application (regardless of the dates to be taken as basis in the correction). In the Repeated Article 298/A-2 of the TPL, the aggregated methods are determined as "simple average method" and "moving weighted average method". On the other hand, according to the Tax Procedure Law Communique No. 338, the aggregated methods that can be taken as basis in the correction of financial statements to be prepared after 01.01.2004 are the "simple average method" and "moving weighted average method" in accordance with the Repeating Article 298/A-2 of the Tax Procedure Law.

Regardless of the 31.12.2003 adjustment, the aggregated method to be selected in the inflation adjustment to be made for the 2004 accounting period shall be taken as basis in the inflation adjustment to be made in the following periods, subject to the conditions in repeating Article 298/A of the TPL, and shall be applied until the end of the third accounting period, including the accounting period in which the relevant method was selected (according to Article 298/A-5 of the TPL).

It is expected that the "simple average method" and "moving weighted average method" will be taken as basis in the correction of the balance sheet dated 31.12.2023. It would be appropriate to follow the secondary regulations to be made by the Turkish Revenue Administration in determining the aggregated method that may be valid for stocks in adjusting the balance sheet.

### **6.4 Deduction from tax base in subsequent accounting periods after determination and adjustment of non-real financing costs**

Non-real financing cost (NRFC) is defined as the amount in all kinds of borrowing calculated by applying the WPI (D-PPI in today's practice) increase rate for the period in which the debt is used, to the debt amounts (in case of foreign currency borrowings, the Turkish Lira equivalents on the date of receipt of the debt) according to repeating article 298/A-2 of TPL.

Again, in paragraph (4) of Article 298/A of the relevant TPL, it is stated that the amounts of non-monetary assets in accordance with the TPL valuation provisions will be taken as basis in the correction process; however, it has been stated that if there are financing expenses included (capitalized) in the cost or purchase price of these assets, these will be separated and deducted from the value subject to adjustment.

On the other hand, in accordance with the provisions of Provisional Article 25/c of the Tax Procedure Law; the unamortized amount from the non-real financing cost deducted from the cost or purchase price of assets whose expiration date has not expired is taken into account as an expense in determining the period's earnings in five years and equal installments in 2004 and subsequent periods. In this context, the non-depreciated amount from the NRFC part deducted from the cost or purchase price of assets whose depreciation period has not ended as of 31.12.2003 has been deducted from the tax bases

of the years 2004 to 2008 by taking into account the "exemptions and Deductions to be Deducted if There is Loss".

It is foreseen that such deduction from the tax base may also be applicable in 2024 and the following years. It would be appropriate to follow the secondary regulations to be made by the Turkish Revenue Administration regarding this issue.

### **6.5 Situation of economical assets which were subject to re-valuation and revaluation growth funds**

Taxpayers have the opportunity to revalue their economic assets based on two different regulations (paragraph (C) of Article 298 of the TPL, Provisional Article 32 of the TPL), although one of them is dependent on the other. On the other hand, the differences between the amount calculated as a result of the valuation of the economic assets in question and their accumulated depreciation (revalued net value) and the pre-valuation economic assets and accumulated depreciation amounts (net value before revaluation) must be taken into the account of special funds within equity capital.

The following issues are required in terms of inflation adjustment to be made on 31.12.2023 according to paragraph (Ç) of repeating article 298 and provisional article 32 of TPL and Serial No.537 General Communique on TPL in case revaluation practice is applied:

- The revalued depreciable economic assets and their related depreciations are subject to inflation adjustment by taking into account their last revalued values, in other words, the values calculated as a result of the last revaluation,
- Considering the last day of the last revaluation period as the basis for the correction process for the economic assets subject to depreciation,
- In inflation adjustment of equity items, inflation adjustment is made by deducting the revaluation value increase fund from the equity capital,
- In addition, if the said value increase fund within the equity capital is added to the capital, inflation adjustment is made by deducting this amount from the capital account.

### **6.6 Determination of adjustment dates of fixed assets capitalized using investments in construction in progress accounts**

According to repeating Article 298/A-3 of TPL; for the tangible and intangible assets included in the assets of companies and the elements that constitute these assets, assets subject to special depletion and the elements that constitute these assets, rights and goodwill; the date of recording in the books should be taken as basis in determining the adjustment coefficients in inflation adjustment application.

In section 12 of the Tax Procedure Law Circular No. 17 dated 24.03.2005, which includes explanations regarding the inflation adjustment in the 2003 and 2004 accounting periods, it is stated that the assets that are capitalized through the "Construction in Progress" account in the balance sheet (entered into this account and later transferred to the relevant fixed asset account). The adjustment dates to be taken into account in the inflation adjustment of the assets (removed from the account) are explained. Accordingly, as the

basis for correction of the values that are not included in the balance sheet as of 31.12.2003, have been transferred to the relevant asset account before the balance sheet date, and have come from the construction in progress account, the dates on which the construction in progress account is used should be taken, not the capitalization dates of the values in question. Therefore, the adjustment of these values will be carried out in two stages. First of all, each expenditure will be corrected until the capitalization date at the end of the month in which the expenditure occurred, and then the capitalized amount will be adjusted as a whole until 31.12.2003.

This approach, which was adopted in the past for inflation correction in the 2003 and 2004 accounting periods, can also be taken as basis in the inflation correction of 2024 and subsequent accounting periods to be made based on the existence of the conditions in Article 298/A of TPL and 31.12.2023. In this regard, it would be appropriate to follow the secondary regulations to be made by the Turkish Revenue Administration.

#### **6.7 Determination of the adjustment date for assets acquired through transfer, division and merger**

Before the inflation adjustment date, companies may become parties to transactions such as transfer, merger and division within the framework of the provisions of the Turkish Commercial Code No. 6102.

According to explanations made under 2.6 section of TPL Circular No. 9 dated 05.08.2004, which includes explanations regarding inflation adjustments in the 2003 and 2004 accounting periods, due to the transfer transactions occurring before 31.12.2003, the date of correction of the economic assets included in the business assets is not the date of transfer, but the date when the assets in question are taken into the inventory of the business eliminated by the transfer. In case of merger, it is stated that the date on which the assets in question are transferred to the records of the merged entity will be taken into account as the date of adjustment.

This approach, which was adopted in the past for inflation correction in the 2003 and 2004 accounting periods, can also be taken as basis in the inflation correction of 2024 and subsequent accounting periods to be made based on the existence of the conditions in Article 298/A of TPL and 31.12.2023.

#### **6.8 The situation of provisions for expenses, which are deemed as in contradiction with provisions of Tax Procedure Law, against Inflation adjustment**

Although certain provisions such as severance pay, employee leave expense provisions, warranty expense provisions, litigation and compensation expense provisions are allocated by entities in order to record possible liabilities to be encountered in the future, these are not among the provisions that can be made in accordance with the provisions of the TPL, so they are taken into account as an additional item in determining the tax base.

According to the explanations in the TPL General Communiqué No. 328, it has become clear that provisions that do not comply with the TPL provisions will not be subject to inflation adjustment.

Again, in the past practice, according to the explanation in the TPL Circular No. 17 dated 24.03.2005, this means that provisions that do not comply with the TPL should be taken into account "as if a provision is not made" in inflation adjustment.

If this approach is also taken as basis when the balance sheet dated 31.12.2023 is subjected to inflation correction in accordance with the provisions of the provisional article 33 of the TPL; the following should be discussed:

- In correcting the mandatory provisions made according to TPL; making adjustments depending on whether the resource is monetary or non-monetary,
- Taking into account the adjustment effect of discretionary provisions that do not comply with TPL and affect the profit for the period in the tax calculation (in determining the corporate tax base of taxpayers who make provisions,

the provision amount is subject to a deduction equal to the inflation difference). Although we are of the opinion that implementation in this direction would be appropriate, it would be appropriate to include an explanation within the secondary regulations to be made by the Administration on the subject.

## **7. Conclusion**

In accordance with provisional article 33 of Tax Procedure Law, balance sheets dated 31.12.2023 (balance sheets dated as last day of accounting period ending within 2024 in terms of firms under special accounting period) shall be subject to inflation adjustment regardless of whether requirements for inflation adjustment occurs or not. On the other hand, it is highly likely to make a inflation adjustment within 2024 accounting period based on currently applicable repeating article 298/A of TPL and level of domestic producer price index (D-PPI), which is announced by Turkish Statistical Institute.

Determining how companies' financial statements have been affected by inflation so far, interpreting the results, and knowing in advance how inflation accounting will affect the tax bases for 2024 and subsequent periods will be decisive in the decision-making stages.

In this article, in accordance with the Tax Procedure Law dated 31.12.2023 and subject to the existence of the conditions specified in Article 298/A of the Law, the regulations and some of the specific issues that provide the basis for inflation adjustment of the financial statements in 2024 and subsequent accounting periods are included. Determinations made by the Administration in Communiques and Circulars regarding the inflation adjustment practice which was applied for 2003 and 2004 accounting periods in previous periods can be considered as guidance for the period dated 31.12.2023 and subsequent periods. On the other hand, it is important to follow secondary regulations such as Communiques and Circulars to be published by the Turkish Revenue Administration regarding inflation adjustment in the period dated 31.12.2023 and subsequent periods.

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