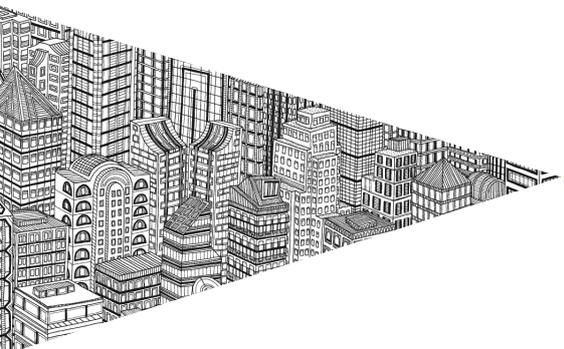


International Tax Alert



Turkey fine tunes tax audits

The need to establish coordination in and standardization of tax audits as well as creating an audit system that protects taxpayers' rights has been a topic of intense public discussion in recent years.

The most common problems encountered in tax audits include:

- ▶ The lack of communication between different units of the tax audit negatively affects taxpayers negatively
- ▶ Uniformity of application still was not established
- ▶ The selection of taxpayers to be audited is not based on objective criteria
- ▶ Subordinate legislation, such as communiqués and circulars, is not taken into account in tax audits
- ▶ Taxpayers' rights are not protected enough in the audits
- ▶ Reports can be issued in conflict with the tax rulings issued by the tax authority

With the Law no 6009, which became effective upon being promulgated in the Official Gazette dated 1 July 2010, important regulations have been introduced that eliminate the abovementioned problems about tax audits.

Reinforcement of coordination

The Tax Audit and Examination Coordinating Committee has been established in order to guarantee the coordination, uniformity of application and information flow between tax audit units, to prepare the annual tax audit plan and follow-up on the application of this plan.

Tax audit is managed through four main channels in Turkey: the Audit Board of Finance and the Tax Inspectors Board operating under the Ministry of Finance, central audit members comprised of Income Controllers established within the Revenue Administration and Tax

Inspectors assigned to the provincial organization of the Revenue Administration.

The abundance of audit units as well as the differences in their incorporation structures as well as the definition of their role directly constitutes a negative factor in tax audits against the taxpayers most of the time.

From time to time, it is recommended that audit are incorporated in order to overcome these problems. It must have been understood that such short-cut solutions would not serve well since the related regulation introduces the following aims:

- ▶ Developing examination standards, principles, methods and techniques rather than incorporating examination units
- ▶ Establishing ethical rules
- ▶ Activating examination planning thereby increasing the service quality of units such that they will operate in greater harmony and cooperation.

Of course, the success of this new structure highly depends on the effective operation of the board and that the studies will be applied rather than just being retained on paper. In this regard, the support that will be given by the examination units to this new structure is critically important.

Objective criteria in selecting taxpayers for tax audit

Sectors and taxpayers to be subjected to a tax audit will be determined under the annual

tax audit plan depending on the risk analysis of the Revenue Administration. Furthermore, Ministry of Finance will regulate the minimum periods for taxpayer groups to be audited according to the scope of tax audits; annual volumes, asset and equity sizes.

Variations in the frequency of taxpayer audits as well as the inability to ascertain the criteria applied to select taxpayers pave the way for “political audit” complaints and, therefore, create a disturbance among taxpayers. With the new regulation, the intention is to provide pre-defined principles and procedures that will be followed during audits, objective criteria for the selection of audit and audit frequency, all of which will ensure justice and impartiality in the selection of taxpayers for audit as well as more effective audits.

Compliance with subordinate legislation

Tax inspectors can no longer issue a tax audit report which is contrary to the decrees, regulations, statutory rules, legislations, general communiqués and circulars issued on tax laws. Inspectors who decide that these regulations are contrary to the tax laws will notify the matter to the Revenue Administration through a report.

The biggest problem faced during tax audits is probably that taxpayers making transactions by relying upon the explanations included within general communiqués published by the authority may be told by the tax inspectors that the explanations in

these communiqués are not binding and a report against taxpayers is issued in the end. As taxpayers are punished by another department of the authority although they act in line with the communiqués and circulars issued by the authority, the state’s credibility is impaired significantly. Accordingly, it is believed that a correct step was taken in prioritizing the available guidance and providing a reliable process for taxpayers to follow.

Assessment of tax audit reports

It is now obligatory that reports issued by central examination officers will be assessed by the report assessment committees in terms of their compliance with the tax laws and other related decrees, statutory rules, legislations, general communiqués, circulars and tax rulings.

As currently applied by some of the tax audit units, tax audit reports are issued after a preliminary reading and review on challenged points to ensure the compliance with the legal legislation. However, we cannot say that these are applied effectively.

With the new regulation, it is targeted that the scope of report assessment practice will be enlarged and the practice will be applied in all audit units. If there is disagreement between the inspector and the reading commission, the audit report will be finalized by the “central report assessment committee” which will be part of the Ministry of Finance as an upper assessment authority. The

reports including the assessment proposal over the amounts determined by the Ministry will be assessed directly by the central report assessment committee in all cases. The committee will comprise nine members to be assigned among the reading commission members of the central audits units of the ministry.

Time limitation for tax audits

Maximum timelines for the tax audits have been determined; accordingly, full audits will be completed within a year and limited audits will be completed within six months.

Although it is a positive development in terms of taxpayer rights, no sort of sanctions has been introduced for cases exceeding these timelines. On the contrary, additional time can be

granted if the audit is not completed within the specified periods. It is hard to understand the necessity of such regulation given that no sanctions exist. Furthermore, the main problem taxpayers have experiences with respect to audit timelines is that return audits take too long. There is no explanation about the timeline for return audits.

Keeping minutes

The notification of the tax audit will be noted in minutes and a copy of the minutes will be given to the taxpayer under audit. Moreover, a copy of the minutes will be submitted to the related unit and another copy will be submitted to the related tax office.

Although it is current practice to report the start of a tax audit through minutes, there is no legal

obligation to do so; as such, arbitrary actions may be observed, such as not notifying taxpayers officially of the commencement of the audit, thereby creating ambiguity for such taxpayers.

Furthermore, not keeping minutes may also lead to not issuing an audit report at the end of the audit. When it is not officially determined that an audit has been started, tax inspectors may easily avoid issuing a report if there is nothing to challenge at the end of the audit. In practice, although many taxpayers have already been audited on a specific issue, they can be audited on the same issue repeatedly since there is no trace in the tax office files that they have been audited on that issue previously.

For additional information with respect to this alert, please contact the following:

Kuzey Yeminli Mali Müşavirlik A.Ş., İstanbul

▶ A. Feridun Güngör +90 212 368 52 04 feridun.gungor@tr.ey.com

International Tax Services

- ▶ **Global ITS**, Jim Tobin, *New York*
- ▶ **Americas**, Jeffrey Michalak, *Detroit*
- ▶ **Asia Pacific**, Alice Chan, *Shanghai*
- ▶ **Europe, Middle East, India and Africa**, Alex Postma, *London*
- ▶ **Japan**, Kai Hielscher, *Tokyo*
- ▶ **Latin America**, Alberto Lopez, *New York*

▶ Argentina	Carlos Casanovas	<i>Buenos Aires</i>
▶ Australia	Daryn Moore	<i>Sydney</i>
▶ Austria	Roland Rief	<i>Vienna</i>
▶ Belgium	Herwig Joosten	<i>Brussels</i>
▶ Brazil	Gil Mendes	<i>Sao Paulo</i>
▶ Canada	George Guedikian	<i>Toronto</i>
▶ Central America	Rafael Sayagues	<i>San José</i>
▶ Chile	Osiel Gonzalez	<i>Santiago</i>
▶ China	Becky Lai	<i>Beijing</i>
▶ Colombia	Ximena Zuluaga	<i>Bogota</i>
▶ Czech Republic	Libor Frýzek	<i>Prague</i>
▶ Denmark	Niels Josephsen	<i>Soborg</i>
▶ Finland	Katri Nygård	<i>Helsinki</i>
▶ France	Claire Acard	<i>Paris</i>
	Régis Houriez	<i>Paris</i>
▶ Germany	Stefan Koehler	<i>Frankfurt</i>
▶ Hong Kong	Chris Finnerty	<i>Hong Kong</i>
▶ Hungary	Botond Rencz	<i>Budapest</i>
	Balazs Szolgyemy	<i>Budapest</i>
▶ India	Vijay Iyer	<i>Bangalore</i>
▶ Ireland	Kevin McLoughlin	<i>Dublin</i>
▶ Israel	Sharon Shulman	<i>Tel Aviv</i>
▶ Italy	Mario Ferrol	<i>Milan</i>
	Gaetano Pizzitola	<i>Rome</i>
▶ Japan	Kai Hielscher	<i>Tokyo</i>
▶ Korea	Kyung-Tae Ko	<i>Seoul</i>
▶ Luxembourg	Frank Muntendam	<i>Luxembourg</i>
▶ Malaysia	Hock Khoon Lee	<i>Kuala Lumpur</i>
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▶ Middle East	Tobias Lintvelt	<i>Abu Dhabi</i>
▶ Middle East	Michelle Kotze	<i>Dubai</i>
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▶ Switzerland	Markus F. Huber	<i>Zurich</i>
▶ Taiwan	Jennifer Williams	<i>Taipei</i>
▶ Thailand	Yupa Wichitkraisorn	<i>Bangkok</i>
▶ Turkey	Feridun Gungor	<i>Istanbul</i>
▶ United Kingdom	Matthew Mealey	<i>London</i>
	Jim Charlton	<i>London</i>
▶ United States	Jeffrey Michalak	<i>Detroit</i>
	Phil Green	<i>New York</i>
▶ Venezuela	Jose Velazquez	<i>Caracas</i>
▶ Vietnam	Carlos Llanes Navarro	<i>Bogota</i>

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