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Inflation adjustment according to Tax Procedure Law in the light of recent regulations and specified issues

1. Introduction

Tax Procedure Law General Communique on inflation adjustment (referred to as "General Communique" hereinafter) has entered into force on December 30, 2023. Yet, TPL Circular numbered 15 on VUK-165/2024-3/Inflation Adjustment Practice (referred to as Circular numbered 165 or "Circular" hereinafter) has been published on 20.02.2024.

2. Inflation adjustment practice in terms of balance sheet of end of 2023 accounting period and 2024 and subsequent accounting periods depending on existence of requirements

When inflation accounting is defined as the adjustment of financial statements that do not reflect the actual situation due to changes in the purchasing power of money to ensure demonstrating actual situation, certain data must be presented from the financial statements of the companies for the mathematical transactions that will enable such adjustment. In this context, some of the specified issues in terms of practice are called to your attention below in the light of up-to-date regulations.

3. Specified Issues in terms of Inflation adjustment

3.1. Situation of retained earnings and losses in terms of 31.12.2023 adjustment

According to provisions of articles 16 and 30 of Serial No:555 General Communique on TPL, retained earnings or current period net profit before the adjustment dated 1.12.2023 are monitored in a sub-account within the retained earnings in the balance sheet after the adjustment, rather than being reset to zero during the inflation adjustment in question. These provisions in the Communiqué should be interpreted that the argument that "retained profits arising from inflation adjustments are withdrawn from the business and should be subject to corporate tax" will not be valid if the previous year or current period commercial profit before the adjustment dated 31.12.2023 is subject to profit distribution after 01.01.2024.

3.2. Subjecting advances to inflation adjustment

According to section 8- adjustment of advance under TPL Circular numbered 165, *"Advances indexed to a certain amount of goods or services will be deemed to be non-monetary and will be adjusted."*

Differences resulting from inflation adjustment of advances received in the nature of non-monetary assets must be transferred to income accounts when the advance is closed. In this way, inflation adjustment differences transferred to income accounts in 2024 or subsequent accounting periods will not be subject to tax if they arise from the 2023 accounting period and will be deducted from the tax base by showing them in the other deductions section of the declaration.

In the 9th section of the Circular, it is stated that advances received and given in foreign currency will be corrected with the exchange rate on the adjustment date and will not be subject to inflation adjustment. As a result, considering that advances in foreign currency are non-monetary in nature, they are subject to exchange rate valuation at the end of the period, it is concluded that making or not making inflation adjustments for these will give the same result.

3.3. Aggregated method applications in subjecting inventories to inflation adjustment

Certain determinations have been made on not amending the selection made in 2024 and aggregated method/actual method selection related to inventories according to Circular numbered 165. In this framework;

Taxpayers' aggregated method preference made as of the first provisional tax period of the 2024 accounting period cannot be changed in subsequent periods, and it is not possible for those who prefer the aggregated method to give up the aggregated method they have chosen for each commodity group and sub-division for three accounting periods.

- The actual method choice made as of the first advance tax period of the 2024 accounting period can be changed in the next accounting period.

- Taxpayers who use the actual method in adjusting stocks will make the adjustment by going to each sub-section as possible.

- Taxpayers who choose aggregated methods are free to use any aggregated method they wish for each commodity group and each sub-division as possible.

3.4. Non-real financing cost application in terms of determining the basis amount for adjustment

In accordance with Article 40/3 of the serial No. 555 Communique, rates in the Communique, limited to the adjustment of the balance sheet at the end of the 2023 accounting period, the non-depreciated amount from the cost of assets whose depreciation period has not expired or the non-real financing cost deducted from the purchase price may be taken into account as an expense in determining the period earnings in 5 years and in equal installments in 2024 and subsequent accounting periods. It is not possible to apply such method in terms of assets tracked under construction in progress.

Non-monetary assets to be separated by ROFM (non-real capitalized financing expenses) in calculating the amount subject to adjustment; stocks, tangible fixed assets, financial fixed assets and special assets subject to depreciation. ROFM separation will not be possible for financing costs incurred and capitalized in the acquisition of intangible assets (e.g. rights, goodwill, research and development expenses, special costs). Intangible assets, including those resulting from financial leasing, which are tracked in the "Rights" account, will not be separated into ROFM during inflation adjustment.

3.5. Determination of adjustment dates of fixed assets capitalized using investments in construction in progress accounts

According to article 20 of Serial No. 555 General Communique, as the basis for adjustment of the values that are not included in the balance sheet as of the end of "2023 accounting period, have been transferred to 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. *Accordingly, the adjustment of these values will be carried out in two stages.* First of all, investment expenditure regarding each month will be adjusted 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 the end of 2023 accounting period.

On the other hand, it is concluded that it would be a defensible practice not to make ROFM separation for financial expenses related to intangible assets followed in the "Construction in progress" account in the balance sheet before the adjustment.

3.6. Adjustment dates for inflation adjustment in case of capital reduction

According to the explanations and examples given in the Circular, unlike the first-in, first-out method, the principle of determining "which increase item was previously added to the capital from which the capital reduction was made" was adopted in determining the adjustment dates of the capital resulting from capital decreases, but the Circular does not explain how this determination can be made. On the other hand, the provision of Article 32/B of the Corporate Tax Law should also be taken into consideration in capital reduction transactions.

3.7. Situation of capital completion fund and capital advances against inflation adjustment

According to Section 4.3. of TPL Circular numbered 165, by using the authority granted to the Ministry of Treasury and Finance by subparagraph (8) of paragraph (A) of Article 298 of Law No. 213, it has been deemed appropriate that the amounts followed in the capital reserves account as capital advances should be accepted as monetary assets and should not be subject to adjustment.

On the other hand, for cash capital increase, if a capital advance payment is made before the capital increase is registered in the trade registry, it can be concluded that this payment date should be taken as the basis for adjustment.

3.8. Transactions to be made on declaration by taxpayers making inflation adjustment

According to article 40/2 of Serial No:555 General Communique on TPL, the following amounts are required to be taken into account by taxpayers while determining the tax basis to be declared on advance tax declaration and annual income tax and corporate tax return to be submitted regarding 2024 accounting period and do not make any additional adjustment:

- Non-deductible expenses arising from non-monetary assets subject to adjustment on the balance sheet are recognized with their respective adjusted amounts,

- Tax-exempt income is calculated with the amounts determined to include the differences resulting from the adjustment of the balance sheets on which such income is determined.

4. Conclusion

Serial No. 555 General Communique on Tax Procedure Law regarding inflation adjustment has entered into force on December 30, 2023 and TPL Circular numbered 165 has been published by Turkish Revenue Administration on 20.02.2024. Even though determinations made regarding the Communique and Circular made in the last two months have clarified certain issues, some cases, which may cause hesitance in practice, are still discussed. This article gives information regarding some of those cases.