Turkey adopts a tax reform: a very small step in the right direction

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FIKRET ADAMAN AND BURÇAY ERUS – EUROPEAN SOCIAL POLICY NETWORK

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On 7 December 2019, Turkey legislated a tax reform, with a higher tax bracket for high-income individuals and new taxes on high-value house ownership, vacation stays and certain digital services. Reforms are limited in scope and not likely to solve the structural problems of informal work and income inequality.

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Description

Turkey has a taxation system that relies heavily on consumption taxes. In income taxation, salaried employees carry the weight. The net average tax rate for a single-earner married couple was 26.2% before the reform, the highest among OECD countries (OECD, 2019). Informality is high: about one-third of the country's economy is informal according to TurkStat. This structure, as opposed to a progressive tax system, puts a relatively heavier burden on poorer households (see Zenginobuz et al., 2010 and Directorate for EU Affairs, 2019 for a detailed analysis). It also results in tax evasion. Given that taxes cannot be levied on the informal sector, the total tax revenue is very low; it is around 25% of GDP whereas the EU-28 average is around 40%.

With the new tax reform, legislated on 7 December 2019, tax brackets were changed and new taxes were introduced.

The reform raises the tax rate from 35% to 40% on gross income above an annual limit of 500,000 TL (€79,365), while also making it possible for these earners to file a tax return and deduct certain expenses, which was not previously possible. It also raises the tax rate for professional football players from 15% to 20%.

New taxes will now also be levied on home ownership, hotel stays and digital services. A wealth tax will be charged on homes at the rate of 0.3%, 0.6% or 1% if their value is between 5 and 7.5 million TL (€0.79-1.19 million), 7.5 and 10 million TL (€1.19-1.59 million) or above 10 million TL (€1.59 million), respectively. People without income or with only social security income will be excluded from this new wealth tax. Stays at tourist facilities will be initially taxed at 1% in 2020 and at 2% from 2021 on. Digital service providers that have a sizeable presence both in Turkey (sales exceeding 20 million TL [€3.17 million]) and abroad (sales exceeding 750 million TL [€119 million]) will pay 7.5% in taxes.

Regarding firms, there are now limits to the expenses that can be written off for car leases. Although a decrease in the corporate tax rate (from 20% to 18%) had been announced, this was not legislated in the tax reform. Similarly, the initial plan to change the method of real estate valuation for the purpose of real estate sales taxation, expected to increase tax receipts, is also not included in the reform.

Outlook and commentary

In response to the tax reform, three labour unions (Türk-İş, Hak-İş and DİSK) issued a joint statement emphasising that salaried individuals will continue to carry most of the tax burden. They ask for minimum wage earners to be exempt from income taxation and also express other demands, including a more progressive taxation system and a reduction in value-added tax for necessities.

The Turkish Industry and Business Association (TÜSİAD) criticises the reform for potentially creating further slowdown in the economy; it also calls for more dialogue to establish a simple and fair tax system with no informal work.

The changes in taxation are very limited in scope, compared to earlier announcements of significant reforms by the Minister of Treasury and Finance. The tax brackets changed only slightly, with no benefits to low-income households. The increase in the top bracket is likely to affect a very limited number of individuals, as will the new property tax on expensive housing.

The reform does not address the informality problem, which continues to be a major drawback in tax collection. The increase in tax rates in the formal sector will further increase the cost of remaining in formal employment.

This initiative can be seen as a small step in the right direction, but further tax reforms will be needed to address the remaining weaknesses.

Further reading

Directorate for EU Affairs (2019). Turkish Ministry of Foreign Affairs, "Chapter on Taxation"; https://www.ab.gov.tr/chapter-16-taxation_81_en.html

OECD (2019). Taxing Wages 2019. OECD Publishing, Paris.

Zenginobuz, Ü, Adaman, F., Gökşen, F., Savcı, Ç and Toksöz, E. (2010). *Türkiye'de Vergiler, Temsiliyet ve Demokrasi [Taxation, Representation, and Democracy in Turkey]*, Boğaziçi University Publications, Istanbul.

Author

Fikret Adaman and Burçay Erus (Boğaziçi University)

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