Tax Expenditure and the Situation in Turkey

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Abstract

Diverged from the standard tax system in order to be used for several economic, fiscal and social purposes, tax expenditures occur as preferential taxation regulations and cause losses to the state. In practice, tax expenditures are implemented as tax exemption, discount and exclusion, tax credits (deductions), discounted rates (tax concession) and tax postponement. In order to succeed in the fiscal policies being followed, it is important to review the provisions of tax laws and other laws in detail, to completely estimate and report the expenditures and to pay particular attention to the budgeting period. While between the years of 2006 and 2010 tax expenditures in Turkey were averagely 8 % of the total tax incomes, the tax expenditures in relation with direct taxes had a rate higher than 80 % in the total tax expenditures.

Keywords: Tax Expenditure, Tax Concessions, Tax Expenditure Reports

Introduction

Tax expenditure is basically means foregone tax revenue and it is not the expenditure made in relation with tax collection. Tax expenditures occur in tax exemption, tax exclusion, tax deduction, discounted tax rates, tax postponing and other similar implementations. The general characteristic of tax exemptions is that they provide advantage (they generate income) for their beneficiaries and they reduce public resources. Still, it is possible to use tax expenditures as a tool for realizing the economic and social purposes of the state within the tax and fiscal policies to be implemented, as an alternative to public expenditures.

1. The Rise of the Concept of Tax Expenditure

The concept of tax expenditure has been initially used by Stanley S. Surrey (Surrey, 1967) and in 1968 tax policy experts of the Treasury prepared the first tax expenditure list under the guidance of Surrey (Sunley 2004: 156; Toder, 2005: 1). In the speech delivered in November 1967 with the title "The United States Income Tax System - The Need For a Full Accounting" by Stanley S. Surrey, the Deputy Minister of the Treasury of the U.S.A. at that time, the concept of "Full Accounting", which meant "federal budget including tax expenditure", was mentioned and it was stated that "the tax system with various exemptions, exclusions, basis and tax reductions, affects private economy as direct public expenditures do, and that this sets forth an expenditure system that is not identified yet in the field of taxation…" (Surrey, 1967).

According to Surrey's "Full Accounting" approach, federal income tax system consists of two parts. While first of these are the obligatory structural provisions for implementing income tax on the incomes of individuals and organizations, the second part is constituted of the tax expenditures system under the public finance support programs carried out with preferential tax provisions instead of direct public expenditures (Surrey, 1973).

2. Definition of Tax Expenditure

Tax expenditure is commonly defined as diverging from a normal, standard or generally accepted tax structure that is formed for achieving certain economic or social purposes and that includes tax losses (OECD, 1984: 168). Tax expenditure can be defined as the public expenditure in the form of tax income loss or postponement resulting from a legal provision in order to reach certain economic or social purposes but that is not in line with the basic obligation system stipulated by law (Tax Expenditures Report, 2007: 5).

Tax expenditures that come up from the tax system and that are separated from the costs for tax collection are the exemptions, exclusions, tax discounts and the cancellations and discounts in relation with other fiscal obligations intended for socio-political purposed implementations and they generally indicate the tax revenues the state gives up (Ozker, 2002: 2; Coskun and Bilen, 2002: 161; Peduk, 2005: 14; Sarac, 2010: 263).

Tax exemption is a type of public expenditure equal to the foregone income or budget expenditures caused by tax postponements, preferential tax rates, deductions, declaration limitations, discounts, exclusions and exemptions that are for certain payer groups or that bring incentives for specific activities, or the additional revenue provided to tax payers by reducing tax load (Bezdek and Zampelli, 1986: 533; Benker, 1986: 403; Balkaya Akca, 2000: 7; King ,1984: 16; Kulu, 2000: 24; Gulmez, 2003: 6; Arcagok, 2002: 49; Bird and Oldman, 1990: 203; Khalilzadeh, 1991: 44; Ozkara, 2004a: ;Ozker, 2002: 2; Gonul, 2002a: 79; Gonul, 2002b: 68-72; Gonul, 2007).

According to the authorities in the IMF and the World Bank, tax expenditures are explained as "the privileges or exemptions and exclusions that reduce the total income of governments and that diverge from the standard tax structure" (IMF, 2001: 5), and "tax concessions differing from the standard tax structure and encouraging behaviors desired by the policy makers" (World bank, 2003: 1).

From the point of the above stated, it is possible to define tax expenditure as "tax exemption, tax exclusion, tax deduction, discounted tax rates, tax postponements and similar implementations that are diverged from the standard tax systems in order to be used for various economic, fiscal and social purposes and that cause losses to the state as preferential tax regulations".

3. Types of Tax Expenditure and Calculation Methods

In practice, tax expenditures are implemented as tax exemption, discount and exclusion, tax credits (deductions), discounted rates (tax concession) and tax postponement. Tax exemption means the complete or partial exemption of the items that are taxable according to tax laws, while tax discount is to make reductions from the tax basis, and tax exclusion is exclusion of individuals or groups that are subject to taxation according to tax laws. While exemption has an objective character, exclusion is subjective. Discounted rates (tax concession) are the implementation of taxes to payers from lower rates, tax credits (deductions) are the implementation of discounts from tax debt, and tax postponement is to allow the tax debt to be paid with a delay.

In general, there are three methods for calculating tax expenditures. These are revenue loss (forgone revenue), revenue obtainment (obtained revenue) and equivalent expenditure (expenditure substitution) (Giray, 2002: 40; Peduk, 2005. 61). Revenue Loss Method is based on the measurement of the lost revenues and it shows the difference between two situations where tax concessions exist and do not exist. Revenue Obtainment Method is based on the estimation of the expected revenue when tax concessions are cancelled.

As for the Equivalent Expenditure Method, it is based on the calculation of the public expenditure amount that will be the subsidiary of a tax expenditure. Revenue loss method is the method that is most commonly used in practice. In addition to these generally accepted methods, another calculation method is the present value method. This method is used for tax postponements. With this method, the present value of the tax appropriated in relation with the tax expenditure for each foreseen year is calculated (Peduk, 2005: 104). Success in the estimation of tax expenditure relies on the secure information flow in countries, cooperation between organizations and the perfection of information sharing. Because, calculations may differ based on the quality of the obtained data and the models developed with the employed method.

4. Reporting of Tax Expenditure Estimates

Reporting of tax expenditure estimates, and particularly inclusion of tax expenditures within budgeting processes enable politicians and government executives to make an evaluation on achieving the targets with the loss of revenue that comes along with tax expenditures in alternative to other public expenditures, and provides important benefits such as increased transparency of public activities in terms of public expenditure analysis, creation of rational taxation systems and a balanced distribution of the tax load (Giray, 2002:38; Peduk, 2005: 104). Today, tax expenditure reports are regularly prepared and integrated with annual budgets in all of the developed countries. Tax expenditure reports should not be considered as documents just providing statistical information. By means of the tax expenditure analysis it may be possible to carry out the benefit-cost analyses of tax concessions, ensure transparency in public finance, determine the changes in tax load due to tax concessions and to determine the distribution of benefit among income groups (Giray, 2002: 49). Tax expenditure analysis may serve politicians or administrators as effective and objective analytical tools in their individual taxation system proposals or their wider tax reform works (Joint Committee on Taxation, 2008: 1).The reasons of countries to implement tax expenditure reporting systems are considered as realizing tax reforms, establishing financial transparency, developing budgeting process and reducing public expenditures (Peduk, 2005: 105).

In a country where no reporting is made income transfer made from public economy to private economy cannot be fully comprehended, redistribution functions with resource allocation may be interpreted incompletely and/or inaccurately, and the fiscal policies followed in an environment where the additional costs incurring from tax expenditures are not known may be inadequate in terms of tools (Sarac, 2010: 268). Tax expenditure reporting system of a country involves the phases of determination of the taxes that will be subject to tax expenditure analyses, identification of tax expenditures, classification of tax expenditures, calculations of the costs of tax expenditures and submission of tax expenditure estimates (Peduk, 2005: 57).

By means of the prepared tax expenditure budget and analysis, measurement of the tax revenues and the economy-wide effects of a realized tax reform, knowing whether the reform has succeeded and the magnitude of the public sector, knowing the amount of the expenditures the state makes through the tax system with the tax expenditure budget added to the budget of the state, and the public opinion and the assembly to audit these expenditures by means of effectiveness and productivity audits can be enabled (Ferhatoglu, 2005: 91). In reporting of tax expenditure, tax legislations of the countries, public expenditures and data regarding tax expenditures have to be determined in detail. If such determination is not made, the reports will only be the numeral manifestation of tax expenditures and realizing tax reforms, ensuring financial transparency and conducting realistic benefit-cost analysis in terms of budget effectiveness will be harder.

5. Economic and Fiscal Effects of Tax Expenditures

Economic and fiscal effects of tax expenditures can be evaluated from several aspects. At first, since some tax expenditures reduce tax revenues and some others cause tax revenues to be postponed (Ozkara 2004b); the income-expense balance of the budget gets distorted and the efficiency in allocation of resources decreases. Since all of the tax payers who possess the conditions stipulated in tax laws can benefit from tax expenditures, these expenditures provide relatively lower flexibility to politicians and bureaucrats at the point of how resource allocation should be, when compared to public expenditures (Toder, 2000: 367). These points are the negative macro effects of tax expenditures on budget and resource allocation. Despite of these problems, tax expenditures can be used as a political tool for encouraging social development and economic growth. Tax expenditures in an economy may serve for an important function such as substituting public expenditures. In other words, as a method for realizing the economic and social purposes of the state, tax expenditures can be an alternative for public expenditures (Dharmapala, 1998: 211). While causing the tax revenues of the state to decrease, tax expenditures increase the usable revenues of the beneficiary tax payers.

Tax expenditures with socio-economic grounds, have the characteristic of being income transfer or an incentive tool for individuals (Sarac, 2010: 271). That is to say that;

- for individuals with low income, tax expenditures mean additional income and will cause their consumptions to increase,
- tax expenditures on the direct taxes for the high income group will enable their savings to increase and will allow them to use this advantage in production.

Since tax expenditure is the tax value abandoned in order to achieve various economic and social targets, magnitude and suitability of the tax expenditure can be determined by evaluating the social and economic policies that constitute the reason of existence of the tax expenditure. However, since the detailed information that will enable such an evaluation is not present on the published tax expenditure statements (Maktouf and Surrey, 1990: 205), today the works and reports to be made on tax expenditure have to be prepared in detail with the aid of information technologies. Particularly due to the effects of tax expenditures on budget balance, evaluations have to be made together with the budgeting process. While the budgetary proposal is discussed by the legislative organ, considering the tax expenditures prepared in a comprehensive way will set light on the tax and financial policies to be implemented.

6. Tax Expenditures in Turkey

In the “Tax Expenditures –Year 2001-” report, which covers the general information on tax expenditures, issued by the Ministry of Finance General Directorate of Revenues, the list for exemption and exclusion regarding tax expenditure was presented. In the “Eight Five-Year Development Plan” it is stated that the tax amount given up by means of the tax exemption will be reported within the scope of budget law in Turkey with the statement that “Tax expenditures such as exemptions, exclusions and tax discount shall be rearranged within the frame of economic and social policies, and the amounts abandoned through tax expenditures shall be reported in details within the budget law” (State Planning Organization, 2001:230).

The concept of tax expenditure has taken its place in Turkish legislation with the 5018 numbered Public Finance Management law of 10.12.2003. In this connection tax expenditures that occur due to tax exemptions, exclusions and discounts have to be included within the Central Management Budget Laws and thus all expenditures are enabled to be seen all together. A work intended for the estimation of the tax expenditures caused by the exemptions, exclusions and discounts, from which data could be obtained, included in the income tax, corporate tax, value added tax and private consumption tax laws was carried out for the first time to be included in the budget of the year of 2006. Similarly, in the budget of the year of 2007 this work was improved in line with the increase in data obtainment (Tax Expenditures Report, 2007: 4). A comprehensive work was started by the General Directorate of Income Policies in order to estimate all tax expenditures as from 2007, occurred due to the tax exemptions, exclusions and discounts stipulated in laws.

Tax expenditure calculations in Turkey are made with the “foregone revenue method” in line with the obtainable data from the concerned organizations, non-governmental organizations and institutions, with Turkish Statistical Institute being in the first place, and the methods employed in preparing the revenue budget. In the budgetary law proposal of each year, the tax expenditure amount of the concerned year and the estimates for the next two years are presented in a table. After the tax expenditures report issued in 2001, as from the year 2006 the tax expenditure list has been started to be published in the annexes of the budget law for Income Tax, Corporate Tax, Value Added Tax and Private Consumption Tax Laws, which constitute the majority of the tax expenditures in Turkey, and some other laws.

The magnitude of the foregone tax revenues within the taxes in force has an importance in terms of the macroeconomic policies. It is important to know the percentage of the collected ones among these taxes, the percentage of the abandoned ones and the amount of the additional tax that can be collected in case tax free sources will be taxed. That is why Table 1 and Table 2 were prepared for.

Table 1 presents the tax expenditure estimates between the years of 2006 and 2013 according to tax types. The 8,6 billion TL tax expenditure in 2006 is expected to be 21,1 billion TL in 2013. While 13,2 billion TL of the total expenditure is the tax expenditure of income tax (foregone revenue), 4,5 billion TL is estimated as the tax expenditure within corporate tax.

Table. 1: Total Tax Expenditure Estimates in Consideration of Tax Types (Billion TL)

TAXES	2006	2007	2008	2009	2010	2011	2012	2013
Tax Expenditure in Income Tax (TEIT)	2.5	7.1	7.8	9.7	10.8	10.8	12.0	13.2
Tax Expenditure in Corporate Tax (TECT)	5.4	3.2	2.9	2.4	2.2	4.0	4.2	4.5
Tax Expenditure in Value Added Tax (TEVAT)	0.4	0.4	0.4	0.9	0.7	1.0	1.0	1.2
Tax Expenditure in Private Consumption Tax (TEPCT)	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.3
Tax Expenditure in Other Taxes (TEOT)	0.1	1.1	1.2	1.4	1.6	1.5	1.7	1.9
TOTAL TAX EXPENDITURES (TTE)	**8.6**	**12.0**	**12.4**	**14.7**	**15.6**	**17.6**	**19.2**	**21.1**

Source: The data in the tax expenditure of the related years presented in the Budget Law and Annexes section in the website http://www.bumko.gov.tr were used.

In Table 2, collected taxes between the years of 2006 and 2010, and the tax expenditure, or abandoned revenues, of the same taxes are compared. Assessing the year 2010 in details, it is seen that there is an 8 % tax expenditure (foregone revenue) on the 210,6 billion TL realized tax. Tax expenditure amount in income tax of that year constitutes a significant rate of 27 % of the total 40,4 billion TL income tax. As for corporate tax, 19 % of the total 20,9 billion TL tax is foregone tax revenue (tax expenditure). Considering also the amount of tax expenditure for this year, the total amount of income tax reaches 51,2 billion TL. When the same consideration is made for corporate tax, the total of the collected and foregone tax reaches 23,1 billion TL. In this sense, it is observed that the foregone tax amount in the direct taxes of the year of 2010 has a significant rate of 83 % within the total tax expenditures.

Table 2: Comparison of Collected Taxes and Tax Expenditure Estimates
(Billion TL; %)

REALIZED TAXES	**2006**	**2007**	**2008**	**2009**	**2010**
Income Tax (IT)	29.0	34.4	38.0	38.4	40.4
Corporate Tax (CT)	11.2	13.6	16.9	18.0	20.9
Value Added Tax (VAT) *	41.3	43.3	46.8	47.0	62.5
Private Consumption Tax (PCT)	37.0	39.1	41.8	43.6	57.3
Other Taxes (OT)	19.0	22.4	24.6	25.4	29.5
TOTAL TAX INCOME (TTI)	**137.5**	**152.8**	**168.1**	**172.4**	**210.6**
TEIT / IT (%)	0,09	0,21	0,21	0,25	0,27
TECT / CT (%)	0,48	0,24	0,17	0,13	0,19
TEVAT / VAT (%)	0,01	0,01	0,01	0,02	0,01
TEPCT / PCT (%)	0,01	0,01	0,00	0,01	0,01
TEOT / OT (%)	0,01	0,05	0,05	0,05	0,05
TTE / TTI (%)	**0,06**	**0,09**	**0,07**	**0,09**	**0,08**

Source: Central Management Realized Budget Revenues data from the website http://www.bumko.gov.tr were used. For percentage calculations the tax expenditure data in Table 1 were used.
* VAT total collected domestically and from imports.

Conclusion

By means of tax expenditures (discount, exemption and exclusion, changing or removing the rates, etc.) which are diverged from the standard tax system and that cause losses to the state by occurring in the form of preferential tax implementations, achievement of various economic, fiscal and social purposes (such as ensuring stabilization, providing incentives for definite products, reducing production of products that are harmful for the society, making arrangements in income distribution for the favor of those with low incomes, etc.) can be contributed to. Usually, in the calculation of tax expenditures, methods such as “revenue loss (foregone revenue)”, “revenue obtainment (obtained revenue)”, “equivalent expenditure (expenditure subsidiary)” are being used whereas in the calculation of tax postponing, “present value method” is being taken into account.

In the reporting of tax expenditure estimations and especially the inclusion of tax expenditures in the budget process provides politicians and public administrators the opportunity to make assessments on how to reach the goals with income loss caused by tax expenditures, taking into account also the alternative public expenditure methods. Some tax expenditures reduce tax income while some others cause the postponement of them but consequently, income-expense balance of budget disrupts and the allocation of resources become inefficient. While tax expenditures cause a decline in government’s tax income, on the other hand, it causes low-income tax payers’ disposable income and high income earner’s savings to increase. In our country studies on tax expenditure are being conducted in the public sector since 2001. In the legislation, there is an important number of tax expenditure. Provisions in the essence of tax expenditure either in tax laws or in any other laws need to be comprehensively reviewed.

While between the years of 2006 and 2010 tax expenditures in Turkey were averagely 8 % of the total tax incomes, the tax expenditures in relation with direct taxes had a rate higher than 80 % in the total tax expenditures. It must be made certain that in the tax and fiscal policies to be implemented, this result should be taken into consideration. The precise estimation and reporting of tax expenditures and dissemination of comprehensive and accurate statistical information by authorized government bodies will increase the chances of successful implementation of financial and especially fiscal policies.

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