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ARAŞTIRMA MAKALESİ / RESEARCH ARTICLE

Thoughts on an Advance Tax Ruling Given about the Recognition as an Expense of Compensation Paid Pursuant to Foreign Arbitration Awards

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Abstract

Compensation paid as a result of foreign arbitration decisions can be taken as expense when determining the tax base. On the other hand, the tax rulings given by the tax administrations look for the enforcement of such decisions as a precondition in order to be able to make an expense depending on the foreign arbitration decisions. However, it is not possible to adopt this approach, just because tax administration want so, which obliges taxpayers to start a legal dispute. It may thought that the tax administration considers the issue as a kind of treasury loss that an untaxed income in Turkey is accepted as an expense for another taxpayer in Turkey. However it is not possible to sustain the evaluation of the tax authorities based on such a reason. In this article, the basic concepts and institutions related to the subject will be explained by using various sources. Later, the illegal consequences of seeking this stipulation by tax rulings, which is not foreseen in the Law, will be discussed.

Keywords

Expense In Taxation • Tax Base • Foreign Arbitration Decisions

Öz

Yabancı tahkim kararları neticesinde ödenen tazminatlar matrahın tespitinde gider olarak nazara alınabilir. Diğer taraftan vergi idaresinin verdiği özelgelerde yabancı tahkim kararlarına bağlı olarak giderleştirme yapılabilmesi için söz konusu kararların tenfizini bir ön koşul olarak aradığı görülmektedir. Oysa mükellefi salt vergi idaresi istediği için hukuki bir uyuşmazlık başlatmaya zorlayan bu yaklaşımı benimsemek mümkün değildir. Vergi idaresinin Türkiye'de vergilendirilmeyen bir gelirin Türkiye'de bir başka mükellef için gider kabul edilmesini bir tür hazine zararı olarak görerek meseleyi değerlendirdiği düşünülmektedir. Diğer yandan böyle bir gerekçeye dayanarak vergi idaresinin değerlendirmesini ayakta tutmak mümkün değildir. Makalede, çeşitli kaynaklardan yararlanılarak başta özelgeler olmak üzere konuya ilişkin temel kavram ve kurumların açıklanmasına yer verilecektir. Daha sonra ise Kanunda öngörülmeyen bu koşulun özelgeler vasıtasıyla aranmasının hukuka aykırılığı ve yaratacağı menfi sonuçlar tartışılacaktır.

Anahtar Kelimeler

Giderleştirme • Vergi Matrahı • Yabancı Tahkim Kararları

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Introduction

International trade and the relations associated therewith have led to a preference for solution of any legal disputes arising therefrom on an international scale. Within this framework, the effect of foreign arbitration awards, that is, of the awards rendered about at least one of the parties in dispute in consequence of handling of the dispute by an arbitrator or an arbitration tribunal outside the country of that party, on the internal law is a subject that has been discussed by various disciplines of law. The effect of foreign arbitration awards on the internal law also invites various discussions in terms of tax dimension of the awards. In this paper, we shall analyse the approach of the tax administration to foreign arbitration awards in terms of recognition as an expense of any payments made pursuant to such awards, and share our opinions on the subject matter.

The advance tax ruling with Ref. No. 19341373-125[ÖZELGE-2013/11]-35, dated 28.04.2014, of the Presidency of Adana Tax Office[2] states in summary that in order that a taxpayer can recognize as an expense of compensations payable by them in consequence of a foreign arbitration award, that award must be enforced, and that if expense recognition is made based on an arbitration award that has not been enforced, the practice will be criticized.

The advance tax ruling with Ref. No. 62030549-125[11-2016/312]-209510, dated 14.07.2017, of the Presidency of Istanbul Tax Office[3] shows that the tax administration preserves this opinion of them. In this advance tax ruling of very recent date, a taxpayer against whom an arbitration award has been rendered as a result of arbitration proceedings in abroad requests an advance tax ruling from the tax administration regarding whether they can recognise as an expense of the compensations that they have become obliged to pay pursuant to the decision of enforcement given at the end of the appeal examination of the arbitral award. While the tax administration expresses the opinion that the compensations paid can be recognised as an expense, an *argumentum a contrario* of the evidence indicated by the administration such that “*[I]n order that a judgment rendered in a civil lawsuit in a foreign country and finalised in accordance with the laws of that country can be enforced in the country where the enforcement of the judgment is sought, the judgment must have been enforced by a competent court in the country. In addition, appeal of such decision of enforcement is also possible,”* shows that the enforcement condition must be satisfied for recognition as an expense of any compensations paid pursuant to an arbitration award.

The main basis of this paper will be the legal evaluation of the approach of the tax administration as shown in its advance tax ruling with Ref. No. 19341373-125[ÖZE LGE-2013/11]-35, dated 28.04.2014.

2 (Online) http://www.gib.gov.tr/node/95341, 12.11.2017

3 (Online) http://www.gib.gov.tr/node/123655, 12.11.2017

Before sharing our opinions, we would like to state that there is no difference between the judgments of foreign courts and the awards of foreign arbitration tribunals and that therefore both the advance tax ruling and our opinions on it are extendable verbatim to judgments of foreign courts.

Terminologically, there is no difference between the terms of “arbitration award” and “arbitral award,” wherever they are used, including the said advance tax ruling, all being meant an arbitration award that finally resolves of a dispute out of court.

I. The Case about which an Advance Tax Ruling is Requested From the Tax Administration, and the Content of the Advance Tax Ruling Given by the Tax Administration

A company being a corporation taxpayer in Turkey (the “Buyer”) made an agreement with a company based in abroad (the “Seller”) to buy a commodity by letter of credit. However, the bank that would issue the letter of credit rejected later on to issue the letter of credit on the excuse of adverse market conditions, upon which the Seller in abroad applied to arbitration in the UK against the Buyer, claiming compensation, by relying on the terms of the agreement signed between them. Although the advance tax ruling states in the respective section that the Seller applied to a court, it actually means the arbitration as the entirety of the ruling indicates.

As a result of the arbitration proceedings, the dispute was concluded against the Buyer, upon which the parties signed a settlement agreement, establishing the amount and the terms of the compensations payable. The Buyer requested from the tax administration a ruling as to whether they were allowed to recognise as an expense of the payments made by them pursuant to the arbitration award and the ensuing settlement agreement.

In the advance tax ruling issued by the tax administration, after the references to the relevant articles of the Income Tax Law and the Corporation Tax Law, it is stated that any payments in nature of compensations made pursuant to an award rendered as a result of arbitration proceedings are allowed to be recognised as an expense. In other words, the tax administration has expressed the opinion that such payments are deductible from the Corporation Tax base, with the condition precedent that the respective arbitration award has been enforced by the respective judicial body in Turkey.

The reasons given by the tax administration for the said condition precedent are the fact that any arbitration award rendered in abroad becomes enforceable in Turkey only after it has been enforced by a Turkish court on the one hand and the fact that the Turkish courts may dismiss an application for enforcement on the other. In addition, the administration reminds that a decision of enforcement given by a local court can be appealed.

In the light of the foregoing, the main idea of the advance tax ruling is that the party against whom the compensations have been awarded must show a legal resistance before paying them and that if the compensations are paid without resistance, they are not allowed to be deducted from the tax base of the respective fiscal period.

II. Legal Nature of the Advance Tax Ruling and of the Decisions of Recognition and Enforcement

Before sharing our opinions about the advance tax ruling which is at the centre of this paper and summarised above, we would like to provide some general explanations about the advance tax ruling and the decisions of recognition and enforcement in order to facilitate the understanding of the subject matter. The reason that we include the decision of recognition in our explanations in this sub-section, though no reference is made to it in the advance tax ruling, is that when the tax administration makes reference to the concept of enforcement in its ruling, it is possible that they actually meant the 'recognition' rather than the 'enforcement', probably for the reason that they do not have full grasp of the respective institutions of the private law.

II.1 Legal Nature of the Advance Tax Ruling in the Turkish Tax Law

An advance tax ruling means a written explanation given by the tax administration as special to a taxpayer upon the application of that taxpayer personally to the tax administration on matter about which the taxpayer is in doubt in terms of the tax practice.[4] An advance tax ruling is an administrative transaction that interprets and explains something, is not enforceable, and therefore is immune to any legal action against it[5]. A taxpayer's request for an advance tax ruling must always be based on a real event[6] and that event must always be related with the own tax obligation of the person, and because of this lawyers, chartered public accountants, financial advisors and similar professionals may not request an advance tax ruling about subjects that are not directly related with themselves[7] unless they have a power of attorney from their client specifically given for this purpose. Various legal systems across the world have the advance tax ruling institution. In the legal systems of the EU-member states, the authority issuing the advance tax ruling varies from one country to another, and some countries charge a fee for issuing an advance tax ruling, but the advance tax rulings are generally deemed binding on the tax administration in the legal systems of the EU-member states to the extent that satisfy the conditions such as 'the situation or

4 **Osman Pehlivan,** Vergi Hukuku [*Tax Law*], Trabzon, Murathan Yayınevi, 2012, p.32.

5 **Billur Yaltı,** Vergisel İzahatlar: Sirküler ve Özelge Düzeninde Değişen-Değişmeyen Hükümlere Genel Bakış [*Taxational Clarifications: An Outlook to Legal Provisions that Change and Unchange by Circulars and Tax Rulings*], A Tribute to Prof. Dr. Sadık Kırbaş, Istanbul, 2011, pp.313-336, p.319.

6 **Leyla Ateş,** Vergi İdaresinde Demokrasinin Vazgeçilmez Aracı Olarak Mukteza [*Advance Ruling by Tax Administration as an Indispensible Means of Democracy*], A Tribute to Prof. Dr. Mualla Öncel, Ankara, 2009, pp.623-655, p.626.

7 **Mehmet Ali Özyer,** Vergi Usul Kanunu [*Code of Tax Procedure*], 3rd Ed., Istanbul, Hesap Uzmanları Derneği Yayınları, 2004, p.943.

the transactions are completely or accurately described in the request - the situation or the transactions realised at a later stage do not differ from those on the bases of which the request was filed - the advance tax ruling is and stays in accordance with domestic, European Union or international law provisions (no contra legem advance tax rulings) - the applicable legal provision on which the advance tax ruling relies did not change - there are no fraudulent means.[8]

The legal basis of the advance tax ruling in the Turkish tax system is article 413, titled 'Taxpayers' Requests for Clarification', of the Code of Tax Procedure. The advance tax rulings are considered not among the binding sources of the tax law but among the auxiliary sources in the foundational textbooks for the reason that they do not establish a new tax norm and that because of this, they permit even the administration issuing the advance tax ruling to execute a transaction which is in contradiction with it subsequently[9]. On the other hand, the legislative amendments over the time have strengthened the position of the advance tax rulings within the tax system, making even the right of the administrative to execute an administrative transaction which is in contradiction with its ruling questionable.

For instance, the law provides late payment interest shall not be charged in addition to the tax penalty to a tax payer who has acted as advised by an advance tax ruling; this gives the advance tax rulings a somewhat binding effect. Similarly, second paragraph[10] of article 140, titled 'Principles Applicable to Tax Inspection,' of the Code of Tax Procedure provides that "*[B]efore the tax inspection reports issued by the Tax Inspectors and the Assistant Tax Inspectors are delivered to the respective tax office for processing, they shall be evaluated by a report evaluation commission formed by minimum three Tax Inspectors who have experience of at least ten years in the profession, for their compliance with the tax laws and the relevant decrees, regulations, bylaws, communiques, circulars, and advance tax rulings. If a difference arises between the person who made the inspection and the commission, the respective tax inspection report shall be evaluated for its compliance with the tax laws and the relevant decrees, bylaws, regulations, communiques, circulars, and advance tax rulings. by a central report evaluation commission formed by the Presidency of Tax Inspection Board with five persons, of whom one is the Vice President acting as the chairman and four are the group presidents as the upper evaluation authority and, if the tax inspection report recommends a tax assessment in an amount exceeding such amounts established by the Ministry of Finance, by the same commission directly. The persons who made the inspection shall issue their tax inspection report in compliance*

8 **Elly Van De Velde,** Tax Rulings in EU Member States, Directorate General for Internal Policies Policy Department A: Economic and Scientific Policy, 2015, p.44.

9 **Selim Kaneti,** Vergi Hukuku [*Tax Law*], 2nd Ed., Istanbul, Filiz Kitapevi, 1989, p.26. Mualla Öncel / Ahmet Kumrulu / Nami Çağan, Vergi Hukuku [*Tax Law*], 17th Ed., Turhan Kitapevi, 2009, p.16

10 This paragraph added to the article by article 9 of the Law No. 6009, which was promulgated in the Official Gazette no. 28659 of 01.08.2010, with the effective date being 01.01.2011.

with the evaluation made by this commission and deliver it to their department for processing." Here, the law indirectly stipulates that a tax inspection report may not impose tax which is in contradiction with any advance tax ruling and thus gives a greater binding effect to the advance tax rulings.[11] In the doctrine, there are opinions that personal advance tax rulings should have a wholly binding effect on any tax matter, including the principal tax. This opinion is based on the argument that the confidence of a taxpayer who has acted in accordance with a personal advance tax ruling in the accuracy of the administrative interpretation in the advance tax ruling as well as the rightful expectation arising from that confidence should be protected.[12]

Also the amendments made by the Law No. 6009 to the principles and procedures applicable to the issuing of advance tax rulings are another factor enhancing the power of the advance tax ruling to give direction to the tax practice. Namely, the following paragraphs have been added by article 15 of the Law No. 6009 to article 413 of the Code of Tax Procedure:

"*The Presidency of Revenue Administration can answer a clarification request by means of an advance tax ruling as well as issue a circular in order to give direction to and clarify the practice in question for all taxpayers in the same situation.*

The circulars and advance tax rulings shall be issued by a commission formed by minimum three heads of departments, chaired by the President of Revenue Administration or a vice president appointed by him, within the body of the Presidency of Revenue Administration.

Where a clarification is requested on an issue which is wholly identical in terms of the subject matter, the scope and the applicable legislation with the issued dealt with in a previous circular or advance tax ruling issued by that commission, advance tax rulings can be issued by the provincial organisation of the Presidency of Revenue Administration, provided that they are in compliance with the circular or the advance tax ruling issued by the commission.

The circulars and the advance tax rulings can be published by the Presidency of Revenue Administration on the Internet, provided that the privacy of the taxpayer is protected in the case of advance tax rulings."

11 **Ertunç Şirin,** Özelge Ve Sirkülerlerin Vergi Hukuku Kaynağı Olarak Konumları Ve İşlevleri: 6009 Sayılı Yasa **Öncesi** Ve Sonrası Durum [*Positions and Functions of Tax Rulings and Circulars as a Source of Tax Law: Situation Before and After the Law No. 6009*], A Tribute to Prof. Dr. Sadık Kırbaş, Istanbul, 2011, pp.230-242, p.238 "[S]ub-paragraph 5 of article 140 of the Code of Tax Procedure, on the other hand, provides that inspectors may not issue a tax inspection report which is in contradiction with the 'tax laws and the relevant decrees, bylaws, regulations, communiques, and circulars,' but the tax rulings are not mentioned here. This implies that a tax inspector can issue a report which is in contradiction with a tax ruling. On the other hand, the paragraphs added to article 140 of the Code of Tax Procedure after the added sub-paragraphs 5 and 6 clearly provide that a tax inspection report issued by a tax inspector shall be evaluated by the report evaluation commissions for its compliance with the 'tax laws and the relevant decrees, bylaws, regulations, communiques, circulars, and tax rulings. This implies that if a tax inspector has issued his report in contradiction with a tax ruling, the report is to be reversed by the commission, just like in the case that it is in contradiction with the law. In other words, it will no longer be possible to issue a report in contradiction with a tax ruling. If a tax is levied based on a tax inspection report which is contrary to a tax ruling, it will be possible to have that tax annulled."

12 **Yaltı,** ibid., p.330.

The regulations introduced later require establishment of an advance tax ruling pool in the first instance. The advance tax rulings included in the pool will be prepared by the commission to be formed as specified in the relevant article of the law, and the local units of the tax administration will select the advance tax ruling answering the question of a taxpayer from the pool and send it to the taxpayer. If the clarification requested by a taxpayer has not been provided by an advance tax ruling previously, it will be notified to the commission, who will issue an advance tax ruling providing the clarification requested by the taxpayer. With this functionality, the institution of advance tax ruling has become more objective and reliable, preventing issuance of any advance tax rulings contradicting each other. Also the publication of the advance tax rulings on the website of the Presidency of Revenue Administration as accessible by everybody is favourable.

On the other hand, the inconsistency between the objectivity given to the institution of advance tax ruling as we explicated above and the first paragraph of article 369, titled 'Mistake and Change of Opinion,' of the Code of Tax Procedure is an issue that must be underlined. The said paragraph provides that:

"*In the event that a taxpayer is given a wrong clarification in writing by a competent authority or that a precedence on the application of a provision has been changed, no tax penalty and late payment interest shall be charged to the taxpayer.*" As it is seen, the positive effects of an advance tax ruling, such as relief from tax penalty and late payment interest, are for the benefit of the taxpayer to whom the advance tax ruling has been given directly only.[13] Accordingly, of any two or more taxpayers who have executed any taxation transaction in compliance with an advance tax ruling providing clarification to such transaction, the one(s) who have obtained a private advance tax ruling from the administration will be immune to any tax penalty and late payment interest, while the one(s) who have not will be burdened with the payment of them; this is not fair. On the other hand, in various studies on the subject matter, it is argued that an advance tax ruling should relieve the taxpayers from any tax, tax penalty and late payment interest assessed and charged in contradiction with the respective advance tax ruling, but it is also emphasized that an advance tax ruling can be used for the benefit of the taxpayer to whom it has been issued only.[14]

II.2 Legal Nature of Recognition and Enforcement Decisions

Judgments of foreign courts are enforceable under the Turkish law by way of either recognition or enforcement of the judgment by a Turkish court depending on

13 **Nurettin Eroğlu,** Vergi Usul Kanunu [*Code of Tax Procedure*], Ankara, Sevinç Matbaası, 1989, p.696. **Gürol Üner**, Güncel Vergi Usul Kanunu Uygulaması [*Current Practice of the Code of Tax Procedure*], Ankara, Yaklaşım Yayıncılık, 2003, p.774 "[I]f a taxpayer acts in accordance with an advance tax ruling given to other taxpayers and if the tax administration criticises the act, the provisions of mistake will not be applicable. In this case, the tax will be assessed together with a penalty."

14 **Christophe Waerzeggers / Cory Hillier,** Introducing An Advance Tax Ruling (Art) Regime, Tax Law, IMF Technical Note, Volume 1, IMF Legal Department, 2016, p.2

the nature of the foreign judgment. In order that the judgment of a foreign court can produce a legal consequence like the judgment of a local court, a decision of recognition or enforcement has to be filed with the respective local court.[15]

An attempt to provide a consummate elucidation as to the legal nature of recognition and enforcement decisions is far beyond the scope of this paper. Therefore, we will confide ourselves to the provision of general information that will allow us to share our findings regarding the Tax Law.

In the doctrine, the recognition is defined as admission of the final ruling power of a court judgment in a foreign country and the enforcement as a mechanism that sets the public power into motion so as to enforce a court judgment owing to its final ruling power.[16]

Article 54, titled 'Conditions for Enforcement,' of the Law No. 5718 on the International Private Law and Procedural Law provides the legal conditions for the rendering of an enforcement decision as follows:

"(1) The competent court shall render an enforcement decision in accordance with the following conditions:

a) If there is a reciprocity treaty between the Republic of Turkey and the state where the judgment has been rendered or if that state's law or actual practice allows enforcement of the judgments rendered by the Turkish courts;

b) If the judgment has been rendered on an issue which is not within the exclusive jurisdiction of the Turkish courts or if the judgment has not been rendered by a court of a state which attributes jurisdiction to itself despite the fact that it has no genuine relevance with the subject matter or the parties of the lawsuit, provided that the defendant party has raised an objection in this regard;

c) If the judgment is not openly against the public order;

ç) If the judgment has not been rendered in the absence of the person against whom the enforcement is requested in the course of the proceedings where that person was not summoned to the court or was not represented by a lawyer in accordance with the law of the state in question and if the person in question has not filed an objection with the Turkish court against the request for enforcement on the grounds of any of the aforesaid facts."

Pursuant to article 58, titled 'Recognition,' of the same Law, the conditions, other than the conditions set forth in sub-paragraph (a) of article 54, apply verbatim for rendering of a recognition decision.

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15 **Cemil Şanlı / Emre Esen / İnci Ataman-Figanmeşe,** Milletlerarası Özel Hukuk [*International Private Law*], 5th ed., Istanbul, Vedat Kitapçılık, 2016, p.482.

16 **Aysel Çelikel / Bahadır Erdem,** Milletlerarası Özel Hukuk [*International Private Law*], 14th ed., Istanbul, Beta Yayıncılık, 2016, p.651.

III. Evaluation of the Advance Tax Ruling Given by the Administration

We must state first of all that in the case discussed here, there is no doubt that the compensations paid can be recognised as an expense pursuant to first paragraph of article 40, titled 'Allowable Expenditures,' of the Income Tax Law No. 193, which reads, "*The following expenditures are allowable in the assessment of the net earnings,*" and to sub-paragraph 3 of that paragraph, which reads, "*Any losses and compensations paid pursuant to a contract or a court judgment or a rule of law, provided that they are related with the business.*" Paragraph 1 of article 6, titled 'Non-Allowable Expenditures,' of the same Law, which reads, "*All fines and tax penalties as well as compensations incurred as a result of any criminal act of the owner of the enterprise (any compensations paid pursuant to a penalty clause of a contract are not deemed compensation of penal nature)*," confirms that any penalty paid pursuant to a contract can be recognized as an expense.

Also Article 11, titled 'Non-Allowable Expenditures,' of the Corporation Tax Law No. 5520, which reads,

"*(1) The following are not allowable in the assessment of the corporate earnings:*

...

e) Any material and moral damages arising from any criminal act of the company or any shareholder, officer or employee of it, except for any compensations paid pursuant to a penalty clause in a contract,"

reinforces this evaluation. Reference to the foregoing provisions of the law as we quoted above has been made by the tax administration in the advance tax ruling given by it.

The aforesaid provisions of law all together show that the legislator accepts any payments made in order to continue the commercial activity as expenditure. As this characteristic of a payment becomes weaker, it becomes difficult, and even impossible, to allow it as an expenditure. For example, it is not readily possible to explain an expense incurred to publish an announcement of death of an employee in a newspaper as an expenditure incurred to continue the commercial activity, with weak reasons such as elevating the morale of the employees, reinforcing the sense of solidarity, etc. aside.[17]

Whether any payments made by a taxpayer are an expenditure in the sense of taxation can always be made a topic of debate by the tax administration, of course. On the other hand, such debate must not be sustained as detached from its context. Every debate raised by the tax administration by way of putting itself in the shoes of the taxpayer and questioning the justifiability of any commercial preferences of the taxpayer is doomed to be detached from its context.

17 **Hayrullah Doğan / Hasan Yalçın,** Vergi Uygulamaları [*Tax Practices*], Istanbul, 2008, p.157.

To explain this view of us with a factual event, the Legislator has ruled that any compensations paid pursuant to a legally valid contract between the parties can be recognised as an expense, event in the absence of a court judgment in this regard. In other words, a taxpayer may choose to pay any compensations pursuant to a contract when he knows that he has failed to fulfil a contractual obligation which requires payment of the compensations, before filing of a lawsuit against him, the results of which would be more detrimental to him, and he can recognise the compensations paid by him as an expense. This is a commercial choice and a legal right of the taxpayer.

Another taxpayer in the same position may become aware that he has failed to fulfil a contractual obligation at the end of resolution of the dispute in question before a court.

When we compare the positions of these two taxpayers, we can admit by relying on the logic that 'many includes few as well' that the taxpayer who has paid the compensations pursuant to a court judgment will be more rightful to recognise the compensations as an expense than the taxpayer who has paid the compensations without a court judgment. Some studies on the subject matter argue that for the reason that the court judgments must prescribe enforcement, a payment may not be recognised as an expense based on a negative declaratory judgment.[18] We are not of the same opinion for the reason that it is possible that a taxpayer knows that he is obliged to pay compensation but finds out its amount as a result of a negative declaratory action. It is even possible that he becomes aware as a result of a negative declaratory action that he has failed to fulfil its contractual obligations. In all such fictional situations, we must accept that a payment has been made pursuant to a contract and that a declaratory action functions to clarify the contract for the taxpayer who has made the payment.

An important point here is that the payment to be recognised as an expense has actually been made. In other words, any compensations debited but not paid may not be recognised as an expense,[19] for any compensations that have become payable after an arbitration award are not an item of accounting that has been related with the profit or loss account before it. For this reason, the principle of assessment, which means that an expense can be allowed once it has been debited to the account, even if it has not been paid actually, under both the corporate accounting and the unincorporated accounting practices,[20] is not applicable here.

18 **Recep Bıyık / Aydın Kıratlı,** Giderler ve İndirimler [*Allowable Expenses*], 6th Ed., Ankara, PWC Business School Yayınları, 2010, p.311.

19 **Abdurrahman Tanrıkulu / Bülent Canani Tuzcuoğlu,** Yabancı Mahkeme Ya Da Tahkim Kurulu Kararlarına İstinaden Oluşan Zarar, Ziyan ve Tazminatların Kurumlar Vergisi Kanunu Karşısındaki Durumu [*Status of Any Loss or Damage Payable Pursuant to a Judgment of a Foreign Court or an Award of a Foreign Arbitration Tribunal Before the Corporation Tax Law*], Vergi Sorunları Dergisi, Sayı 114, Istanbul, Maliye Gelirler Kontrolörleri Derneği Yayınları, pp.11-20, p.18.

20 **Safiye Öngen,** Vergi Muhasebesi [*Tax Accounting*], Ankara, Yaklaşım Yayıncılık, 2000, p.519. Doğan Şenyüz / Adnan Gerçek / Mehmet Yüce, Türk Vergi Sistemi [*Turkish Tax System*], Ankara, Yaklaşım Yayıncılık, 2008, p.11 "[I]f a taxpayer has incurred an expense but not yet paid it, that is to say, if he has become indebted, this expense is allowable pursuant to the principle of assessment and will be entered into the records, for the expense is considered an income for the opponent party pursuant to the principle of assessment."

Going back to the approach of the tax administration, we find that the tax administration, in its said advance tax ruling, forces the taxpayer to sustain the dispute despite the fact that the taxpayer is aware that he is the wrongful party before the court. Moreover, the nature of this forcing is not to sustain the legal debate, for the enforcement is in essence the enforcement of the underlying judgment. The purpose of a trial for enforcement of a foreign court judgment or arbitration award is not to make a legal review of the merits of the case in dispute. A trial for enforcement only makes an analysis as to whether the foreign court or arbitration tribunal has jurisdiction to render a judgment or an award on the case or not and whether the trial has been done in accordance with the law chosen by the parties or not and whether the parties have been allowed to use their right to defend their case or not.

As the present system requires a taxpayer, who wishes to pay compensations based on an arbitration award, to obtain an enforcement of the underlying award, it forces the taxpayer to incur interest, expenses of the trial for enforcement, and attorney fees. Moreover, the creditor who has obtained the enforcement of the award can immediately apply to the debt collection office in order to collect the debt, in which case the debtor will additionally incur debt collection expenses.

The advance tax ruling also reminds that "*In addition, the enforcement decision can be appealed.*" This suggests that the tax administration may not be satisfied with the result of the action for enforcement and may require the use of any legal remedy available. However, there is nothing in the legislation that justifies the tax administration to be so hesitant and suspicious toward the taxpayers who are willing to pay the compensations pursuant to a foreign arbitration award and recognise them as an expense accordingly.

A private person who has lost his case before a foreign judicial body after a serious trial and has been convinced of his wrongfulness based on the reasoned judgment or award should not be forced to start a new dispute merely for the sake of satisfying any tax concerns and completing a formal formality. Just as a taxpayer who has lost his case before a local court pays the awarded compensations without appealing the judgment of the court and accordingly recognises the compensations as an expense in the domestic legal system, the taxpayer must be able to do the same based on a foreign court judgment or arbitration award.

In our opinion, the reason why the tax administration gives such an advance tax ruling is their desire to prevent any loss of revenue by the treasury. That a tax arising from a contractual relationship between the parties is paid to the treasury of a foreign country and that the amount so paid is recognised as an expense and deducted from the tax base in Turkey is not a favourable development for the Turkish treasury, of course. On the other hand, there is not a norm of positive law that allows the practice accepted by the tax administration as a solution.

Let's assume a case where two local companies paying tax in Turkey have referred a dispute between them to and solved it through a foreign arbitration tribunal. If the tax administration requires enforcement of the arbitration award in Turkey, it will be contrary to the law in addition to the problems explained so far, for the party who has won the case and received the payment will add it as an income to its tax base. The basic principle of the Turkish Tax Law is that an income for a party is an expense for the other. A view contrary to this will mean a duplicate taxation for the benefit of the tax administration. In such a hypothetical event, a taxpayer who has recognised a payment made by him pursuant to an unratified arbitration award as an expense cannot be criticised.

Some studies on the subject matter agree with the tax administration by arguing that the arbitration trial is a way of amicable settlement of disputes, and some even claim that payments made pursuant to an arbitration award may not be recognised as an expense.[21] However, the arbitration trial is not a way of amicable settlement of a dispute. The parties have agreed on the duty and jurisdiction beforehand. This agreement is not different from the prior agreement on the competent court. The only reason why the parties go to arbitration is actually the fact that they could not have amicably settled the dispute. The fact that an arbitration award can be rendered without the participation of one of the parties in the arbitration proceedings and that the consequences of such award will be binding like a judgment of a foreign court shows that the arbitration trial is not a way of amicable settlement of disputes. Moreover, even if it is possible to accept for a moment that the arbitration tribunal is an amicable settlement of a dispute, there is not any legal obstacle for recognising as an expense of a payment made under an out of court settlement agreement.[22]

One can think that the tax administration should require at least a recognition decision in the absence of an enforcement decision so as to allow a taxpayer to recognise as an expense of the compensations paid by him. In our understanding, to demand a recognition decision, too, lacks a legal basis, for the obtaining of a recognition decision will be a loss of time and money for the taxpayer who has made the payment. In view of the fact that a taxpayer who has become aware that he is obliged to pay compensations pursuant to the contract and has paid the compensations without a court judgment can recognise as an expense of the sum paid as compensations, criticising a taxpayer who did the same on the grounds that he failed to have the judgment recognised by the local jurisdiction will be a contradictory approach. Even when this problem is addressed strictly in terms of taxation technique, we have the

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21 **Tanrıkulu / Tuzcuoğlu,** ibid., p.20 "Any loss or compensation paid pursuant to foreign arbitration awards which have been finalized and become enforceable may not be recognised as an expense for the reason that the arbitration procedure is in essence a way of amicable settlement of disputes. As frequently seen in the practice, however, faced with a dispute in abroad, companies can be forced to go to arbitration by the respective foreign country, even if they are relatively rightful. Where their ability to continue their commercial activity depends on their acceptance of the arbitration as a result of such forcing, since the arbitration will have been accepted for the sake of continuing and maintaning of the commercial relationship, any loss or compensation paid pursuant to the arbitration award can be recognised as an expense as per article 40/1 of the Income Tax Law."

22 **Özyer,** ibid., p.685.

opinion that the tax administration may criticise a taxpayer who recognised as an expense of a payment during the year when the decision of recognition was obtained on the grounds that by doing this he aimed an irregular tax planning.

Even if we assume that the tax administration is rightful to demand a recognition decision in the cases when it is difficult for it to see the relationship between the payment and the contract in terms of the law of evidence, we have the opinion that a more practical solution should be adopted in this regard. Accordingly, submission of a copy of the duly notarized translations of the arbitration contract or clause between the parties and of the arbitration award should be accepted as sufficient proof of the basis of the compensations paid. These will constitute the proof of the compensations paid and recognised as an expense. This approach will be consistent with the provision of first paragraph of article 322, titled ‘Worthless Receivables,’ of the Code of Tax Procedure No. 213, which reads, “*Any receivable which is no longer collectible as proven by a court judgment or by an opinion-giving document.*”

Conclusion

The belief that the Legislator has not established adequate legal mechanisms to protect the treasury and that, therefore, the administration has a duty to protect the treasury when it needs protection, though such a duty has not been explicitly assigned to the administration by the law, is a false notion frequently pursued by the administration.

Imposition of some conditions that are not provided in the law for recognition as an expense of a payment incurred as a result of a commercial activity and made compulsorily because of this is contrary to the law on the one hand and puts additional burden on the taxpayer as the meeting of such conditions will require the taxpayer to incur expenses. In this regard, the administrator’s imposition of certain conditions precedent which are not provided in the law for the use of certain rights allowed by the law in the realm of taxation creates a problem that must be addressed in terms of the legality of such conditions imposed by the administration.

To think that a taxpayer will personally have a court judgment or an arbitration award rendered against him in abroad ratified is not meaningful, for this will be like expecting the taxpayer to initiate a debt collection proceeding against himself. Therefore, by demanding an enforcement decision as a condition precedent to the recognition as an expense of the compensations paid, the tax administration is actually compelling the creditor of the taxpayer to initiate the debt collection procedure at the expense of the taxpayer who will incur more expenses.

If the taxpayer believes that the arbitration award cannot be enforced in Turkey, he may by his free will take such steps that will ensure the stepping-in of the judicial process in this regard. On the other hand, respect must be shown to the will of a taxpayer to end a

dispute once he has been convinced of his wrongfulness after the arbitration award and as he does not want to bear more financial burden. An approach contrary to this will become an interpretation of the right to have access to court as protected by article 36, titled 'Right to Legal Remedies,' of the Constitution, which reads, "*Every person has the right to fair trial through claim and defence as plaintiff or defendant before judicial bodies by using legitimate means and ways,"* that turns that right into an obligation.

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