

Unconstitutional Application of Special Consumption Tax in Turkey

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According to the Turkish Constitution, taxes, fees, duties, and other financial impositions must be imposed, amended, or revoked by law. An exception is that the Council of Ministers can be empowered to amend the percentage rates of exemption, exceptions and reductions in taxes, fees, duties and other financial impositions, within certain upper and lower legislative limits.

The Council of Ministers must carefully consider proportionality when exercising this discretion to ensure a correct balance is established and maintained between the motives for such delegation and the implementation approach.

Special Consumption Tax ("SCT") is a good example of how the power granted to the Council of Ministers in this respect can give rise to unfair results. SCT is imposed in different ways on a large number of products and industries. The tobacco sector has drawn particular attention in this context because the SCT structure has developed to mean that products at the lower end of the market are taxed at proportionally higher rates than products at the upper end of the price spectrum.

Arguably, the Council of Ministers may have exercised its discretionary power with regard to SCT in the tobacco sector in an unconstitutional manner. If so, affected persons and legal entities are entitled to recourse and to seek relief on the basis that their constitutional rights have been violated.

Special Consumption Tax

SCT is an expenditure tax, collected on certain items either via a minimum collectible excise or by applying a proportional *ad valorem* rate to the retail price. SCT was introduced in Turkey in 2002 with Special Consumption Tax Law Number 4760 ("SCTL").

The goods subject to SCT are exhaustively stipulated in lists annexed to the SCTL, including: gasoline, oil products, tobacco, cigarettes, alcoholic beverages, televisions, mobile phones, refrigerators, motor vehicles.

Turkish tax law contains many provisions which grant the power to make legislation to the Council of Ministers. Accordingly, the SCTL empowers the Council of Ministers to change the percentage rates for SCT.

However, legally controversial practices and consequences could result from granting the executive body the power to carry out certain regulatory acts regarding taxation. In principle, such powers should fall within the scope of the legislative body's power.

Therefore, companies conducting commercial activities within the scope of SCT could have their rights violated as a result of unlawful acts and transactions by the Council of Ministers.

Constitutional Taxation Principles

The power of taxation has its grounds in the Constitution of the Republic of Turkey (the "Constitution"). The fundamental constitutional principles regarding taxation are outlined in Article 73 of the Constitution:

Everyone is under obligation to pay taxes according to his financial resources, in order to meet public expenditure.

An equitable and balanced distribution of the tax burden is the social objective of fiscal policy.

Taxes, fees, duties, and other financial impositions shall be imposed, amended, or revoked by law.

The Council of Ministers may be empowered to amend the percentages of exemption, exceptions and reductions in taxes, fees, duties and other financial impositions, within the minimum and maximum limits prescribed by law.

In the light of Article 73, the Council of Ministers can legitimately change the percentage of an existing tax, provided the change remains within legislative limits and the Council of Ministers has been granted this authority. However, the Council of Ministers must also comply with the main constitutional taxation principles.

The "ability to pay" principle is a fundamental principle of tax law. Taxation according to a party's ability to pay ensures equitable taxation. "Financial resources" referred to under Article 73 of the Constitution refers to the ability to pay tax. As a given party's financial ability increases, the burden of tax should also increase.

In addition, the principle of equitable and balanced distribution of the tax burden is a natural outcome of the constitutional principles of social state and rule of law (Article 2 of the Constitution). The Constitution imposes an obligation on the state to secure social justice through equitable taxation and to establish economic and social balance.

The Boundaries of the Power Granted to the Council of Ministers by the SCTL

Boundaries on the power granted to the Council of Ministers are outlined in Article 12 of the SCTL, including the following.

- **Changing tax rates:** The Council of Ministers can change a tax rate, provided the change remains within legislative limits and it has been granted authority to make the change.
- **Changing the amounts of minimum specific tax:** The power to change the amount of minimum specific tax is not explicitly granted to the Council of Ministers by Article 73 of the Constitution. Therefore, making and enforcing such a change could mean that the Council of Ministers is exceeding its constitutional powers.

However, other pieces of tax legislation contemplate the Council of Ministers being granted the power to change the amount of minimum specific tax, within prescribed limits. The Constitutional Court states the power can be legitimately exercised to compensate for depreciation caused by inflation, without violating Article 73 of the Constitution. However, the Court notes that to avoid arbitrary practices, the most objective and impartial approach is to use the revaluation percentage announced each year by the Ministry of Finance.

- **Determining different tax amounts according to the types, qualities, price groups, alcohol percentage and amount of alcohol content for goods.** Determining tax amounts in this way is not within the powers granted to the Council of Ministers by Article 73 of the Constitution. However, members of the Constitutional Court have differing opinions on this topic.¹

Turkey's Tobacco Market

The state monopoly of production, distribution and sales of tobacco products was lifted in 1986. Manufacturing companies received the power to price the produced cigarettes in 1991.

Turkey's tobacco market currently consists of four categories, with the determining factor being price (Competition Board Decision numbered 08-26/28492, dated March 27, 2008). The customer-price-market policy allows manufacturing companies to determine which category their products fall into:

- Premium;
- Medium;
- Low;
- Cheap.

While tobacco and tobacco products fall within the scope of the SCTL (Schedule B of List number III in the annex of the SCT), the Council of Ministers must consider these price groups when determining the SCT amount and percentage.

A dual taxation system exists for tobacco and tobacco products, with either:

- *ad valorem* rate, proportionally applied to the sales price; or
- minimum specific tax.

If the proportional *ad valorem* tax is below the minimum collectible excise, the minimum specific tax must be paid instead. However, this structure allows for the same tax amount to be collected for inexpensive and expensive goods. If this occurs, the "ability to pay" taxation principle would be violated.

According to the current amount and percentages, 65.25% SCT applies for cigarettes containing tobacco.² However, under the dual system, a minimum specific tax of 4.42 Turkish lira per package also applies (0.2210 Turkish lira per item in tariff).

When this percentage and amount are considered, it is clear that cigarettes in the "Low" and "Cheap" categories are taxed at proportionally higher rates than those in the "Medium" or "Premium" categories:

- The *ad valorem* rate will never apply for cigarettes sold at or below 6.78 Turkish lira. Rather, the specific tax of 4.42 Turkish lira per package will apply, irrespective of how much less than 6.78 Turkish lira the sale price is. As a natural outcome of this, cigarettes in the "Low" and "Cheap" categories are subject to SCT rates at a higher rate than 65.25%.
- The minimum collectible excise will not apply for cigarettes sold for more than 6.78 Turkish lira. For sales above 6.78 Turkish lira, tax calculated at a rate of 65.25% will already be above 4.42 Turkish lira, the minimum collectible excise.

Amendments to the SCTL over time by the Council of Ministers have developed the current approach. However, the dual taxation system for tobacco undermines competition for cigarettes in the "Low" and "Cheap" categories. The structure contradicts the "ability to pay" principle, as well as principles of equity and

proportionality.

All of the major multinational tobacco companies conduct operations and do business in Turkey. Since these companies have products in the "Low" and "Cheap" categories, they are inevitably subject to unlawful and unconstitutional taxation.

In the light of this, we are of the opinion that the legislation in question could be annulled by judicial review, on the basis that it violates the constitutional principles of "ability to pay", equity and proportionality.

Conclusion

Where the Council of Ministers is granted discretionary power, such as in the scope of the SCTL, proportionality must be carefully considered.

Granting power to the Council of Ministers does not mean that it can act arbitrarily, or contrary to imperative legislative or constitutional provisions. However, legislative acts by the Council of Ministers with regard to taxation have developed an unlawful situation within the tobacco sector.

In such cases, the affected persons and legal entities are entitled to have recourse to the judicial authorities and seek relief on the basis that the Council of Ministers' use of discretionary power is contrary to law and violates their constitutional rights.

1. Decision of the Court of Constitution dated February 21, 2008 and numbered 2005/73 E., 2008/59 K., Dissenting Opinion of Judge Zehra Ayla Perkta (Official Gazette dated November 7, 2008 and numbered 27047).
2. Council of Ministers' Decree numbered 2015/8353 on December 29, 2015.

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