Chapter 13
Political Economy of Tax Evasion and Tax Loss in the Real Estate Sector:
A Property Tax Reform Proposal for Turkey

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ABSTRACT
This chapter engages with political economy of tax evasion and tax compliance issues, particularly focusing on deficiencies and problems within property taxation system in Turkey. The chapter questions if there are any political preferences, legal arrangements or cultural issues facilitating tax evasion and tax loss in Turkey. It first identifies the degenerating effects of frequent application of tax amnesties, having a lax tax reconciliation institution, and less than logical way tax information confidentiality principle is applied in Turkey. Then, the chapter investigates peculiarities and specific difficulties of real estate sector in general in relation to taxation. Finally, a comprehensive property tax reform based on a semi-public valuation system is proposed to reduce tax loss in this sector.

INTRODUCTION
The most important weakness of the Turkish tax system is related to the large amount of unregistered economic activities and the high percentage of tax fraud among the registered tax payers. What follows is that tax revenue remains low with high economic and social costs. As will be elaborated later, tax constitutes a form of political interaction and it is important to understand how key actors can use the institutions and regulations in their own favor and how they be able to exert pressure over policy design and implementation.

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Real estate sector, which is the focus of this chapter, is significantly different from other sectors in terms of the reasons why tax loss and evasion occur. First of all, why unregistered economic activities exist in this sector is not because it is difficult to get hold the tax subject since they have physical bodies that cannot be hidden or transferred to somewhere else. Thus, the informality in this sector has come out as acquiescence of the current condition by the governments due to the political reasons.

Probably because of the cultural legacy of the Ottoman Empire, the Turkish tax authorities have always exhibited a mild attitude towards real estate taxation in Turkey. As a result, real estate taxes have occupied almost a negligible share within the public revenue. Income generated from the real estate is taxed mainly in three ways in the Turkish tax system: 1) Taxing the rental income of immovable properties; 2) Taxing the real estate itself; and 3) Taxing the appreciation gains resulted in a transaction. According to Ministry of Finance (2015) figures, the revenue from property taxes was less than 1 percent of Gross Domestic Product (GDP) and only around 3.5% of total tax revenues in Turkey. This is much lower than the average in the OECD where property taxes amount to 2% of GDP and to around 5.5% of total tax revenues.

The chapter is structured as follows. The next section reviews political economy of taxation. It first provides a brief overview of the literature on tax evasion and tax compliance to reveal the motives behind tax noncompliance and then it engages with the political economy of tax related issues, such as power balance, voters’ and politicians’ perspectives. This section also questions if there are any political preferences and legal arrangements that facilitate tax evasion and tax loss in the real estate sector in Turkey. In answering this question, the section discusses the harmful effects of many tax amnesties enacted, having a lax tax reconciliation institution, and the exaggerated way tax information confidentiality principle is applied in Turkey. The third section investigates peculiarities and specific difficulties of the real estate sector in relation to taxation. The fourth section looks for possible solutions to tax evasion and tax loss problems in the real estate sector in Turkey and proposes a property tax reform based on a semi-public valuation system. The last section provides concluding remarks.

BACKGROUND: POLITICAL ECONOMY OF TAXATION

A Brief Literature Review: Tax Evasion and Tax Compliance

A deliberate omission of a statutory requirement to reduce or eliminate a tax liability is called tax evasion. Tax evasion is a pervasive and widespread phenomenon that entails important economic and social consequences. For instance, there can be massive revenue losses with a reduction in spending on health, education, social security, infrastructure, and other needed public programs. Tax evasion also “creates major misallocations in resource use, alters the distribution of income in arbitrary, unpredictable, and unfair ways, and it may contribute to feelings of unjust treatment and disrespect for the law” (Alm, Bloomquist, & McKee, 2015, pp. 1170-1171). In short, “tax evasion represents a violation of fundamental social values leading to deleterious economic and political consequences” (Sossin, 1992b, p. 127). Increasing revenue through a reduction in tax evasion might ease the burden on economic agents who pay taxes and promote growth and equity by enhancing both allocative efficiency and incentives to invest and produce (Wadhawan & Gray, 1998).
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