GURULKAN ÇAKIR

Elimination of International Double Taxation under Turkish Law

Introduction

States exercise their power of taxation as a reflection of their sovereignty. However, intensification of international relations, the economic interactions of countries with each other, multinational companies operating on a global scale and the free movement of products have raised the problem of taxation in international economic activities.

Each state has a separate tax regime; therefore, the same taxpayer may be taxed in more than one jurisdiction for the same source of income. This is defined as international double taxation. Double taxation may create adverse effects on the trade of goods and services and international mobility of capital, technology and labor. Furthermore, it contradicts justice in taxation and the ability to pay principles.

In Turkish law, there are a number of regulations on prevention of double taxation to bring external sources to the country and to help the production capacity of the country.

The main purpose of these regulations is to incentivize foreign investments that brings capital, technology, as well as new management structures, and also to protect the foreign investments in order to create convenient investment environment.

The aim of this article is to examine international double taxation under Turkish law.

Taxation Principles

Systems of taxation vary among governments. However, within the framework of the principles of international law, the determination of the taxation authority and the scope of the tax laws are based on two principles: territoriality principle and personality principle.

Territoriality Principle: The fundamental axiom of international law is that the state is deemed to exercise exclusive jurisdiction over its territory. Its reflection on tax regime is that the principle of levying tax is valid only within the territorial jurisdiction of a sovereign country. Territoriality principle is justified by the view that the country which provides the opportunity to generate income or profits should have the right to tax it.

Under the source principle, a state is entitled to tax the non-residents on the income they derive from sources within the country regardless of their citizenship. The legal relationship is based on the economic bond; therefore, the rules on tax law apply to all citizens and foreigners in the country.

In Turkish legislation, non-residents and those who do not spend more than a continuous period of six months in Turkey within a calendar year are taxed only on their earnings and income derived in Turkey. So, they are taxed on their income sourced within the country.

Personality Principle: The relationship between the taxpayer and the taxing state is either based on citizenship or residency.

A taxpayer is taxed either due to its residency or citizenship, regardless of the country from which he/she has earned his/her income and typically taxed on its worldwide income.

For example, under Turkish tax legislation, the inheritance tax law is applicable to the goods that Turkish citizens can acquire in foreign countries. This shows that citizenship relation gives the power to tax the income and wealth around the world under Turkish law.

Another example is the residents who reside in Turkey or spend more than a continuous period of six months in Turkey within a calendar year. These taxpayers are taxed on their earnings and income derived in and outside of Turkey. Similarly, corporations with legal or business centers located in Turkey are qualified as residents and are subject to tax on their income derived in Turkey and other countries.

International Double Taxation

The concept of International Double Taxation is uncertain as there is no common definition in the international and national literature.

In general, international double taxation occurs when the same taxpayer is subject to more than one taxes for the same taxation source in the same taxation period due to the overlap of the power of taxation of states.

International juridical double taxation is defined as *"the imposition of the same or comparable taxes in two or more states on the same taxpayer in respect of the same subject matter and for the same taxation period"* under OECD's Model Tax Convention on Income and on Capital.

States apply taxes on the incomes of individuals gained on their territory while these incomes might also be subject to the taxation in the state of taxpayer's origin and as a result international double taxation arose. Furthermore, the different fiscal policies and the taxation systems of each state may lead to the double taxation. Concepts which are the basis for the taxation such as the residence, the nationality or the territoriality, may have different interpretations in different states.

Avoidance of International Double Taxation

In Turkey, the problem of international double taxation is tried to be prevented by unilateral legislative measures as well as bilateral tax agreements.

Unilateral Legislative Measures

The avoidance of the double taxation by unilateral legislative measures is not easy since every state is willing to generate income as much as possible.

In Turkey, there are various tax regulations to decrease or eliminate international double taxation considering its multidimensional adverse effects on international trade. However, there is no general provision under Turkish law in terms of limitation. In this context, there are two methods used in different tax laws: the credit method and exemption method.

Credit Method: The foreign-sourced income is taxed in Turkey but the tax paid abroad is deducted from total amount. The deductible tax is treated as an expense of taxpayer. The credit method completely prevents double taxation.

- **Income tax:** If a taxpayer who has unlimited tax liability in Turkey pays income tax on his earnings and income derived outside Turkey in a foreign country, it may be deducted from the total income tax.

- **Inheritance tax:** If a Turkish citizen pays inheritance tax to foreign authorities for a property located in a foreign country, this payment is deducted from the total inheritance tax burden of the individual in Turkey.

- **Corporate tax:** In general, territoriality principle is applied in determining tax liability for legal entities whose registered head office is situated in Turkey, or the center of all business transactions in Turkey. These legal entities are taxed on their worldwide income. However, the income derived from the services rendered in Turkey which are solely utilized abroad may be subject to a 50% deduction from corporate tax base.

Exemption Method: The country where the taxpayer is resident cedes all power of taxing to the source country. Many countries, including Turkey, use some version of exemption of territorial source system for international taxing income. Under such system, some of the domestic taxpayer's income from foreign sources are exempt from tax in the country of residence. This provides justice

between the domestic investors and the foreign investors in the country.

In the exemption method, only one country fully exercises its taxation power. Therefore, international double taxation based on residence can be prevented completely.

- **Income tax:** Taxpayers who reside in a foreign country due to the activities of official institutions or corporations with legal or business centers located in Turkey are exempted from their earnings and income derived outside of Turkey if they have already been taxed in the country of residence.

  Corporations with legal or business centers that are not located in Turkey are qualified as non-residents and are subject to tax only on their income derived in Turkey. The income derived in foreign country is exempted.

- **Corporate tax:** Dividends received by a Turkish company from a resident corporate taxpayer are not subject to corporate income tax. The exemption is also available for non-resident companies to the extent that the dividends are attributable to a Turkish permanent establishment or branch.

- **Inheritance tax:** A foreigner who acquires a Turkish citizen's property located in a foreign country by way of inheritance, is exempted from inheritance tax in Turkey.

- **Value added tax (VAT):** Commercial, industrial, agricultural, and independent professional goods and services imported into the country, and delivery of goods and services as a result of other activities are all subject to VAT. VAT exemptions include, but not limited to the following:
  - export of goods and services,
  - roaming services rendered in Turkey for non-resident customers in line with international roaming agreements where a reciprocity condition is in place
  - transit transportation,
  - deliveries and services made to diplomatic representatives and consulates on condition of

reciprocity and to international organizations which have tax exemption status and to their employees,
   - supply of machinery and equipment within the scope of an investment certificate.

- **Withholding tax:** Dividends paid to an entity residing in Turkey or a Turkish branch of a foreign company is not subject to withholding tax.

Bilateral Agreements on Preventing Double Taxation

Double Taxation Agreements ("the agreements") are treaties between two or more countries to avoid international double taxation of income. They specify which state has taxing rights over an individual, and, if they both have such rights, which one takes priority.

Turkey has concluded several agreements on tax matters with 94 states and 84 of these are already in effect. Citizens and individuals with a permanent residence with full and unlimited tax liability in either one of the contracting states may be entitled to exemption or reduction from taxation of income and property according to provisions of the respective agreements.

The main purpose of those agreements is not only to divide the right of taxation between the contracting states, but also to ensure equality between taxpayers and to attract the foreign investors.

To avoid double taxation with tax treaties, Turkey uses OECD or UN Model Tax Conventions. OECD Model is preferred for making agreement with developed countries, whereas UN Model is appropriate for making agreement with developing countries.

It is worth noting that there are various reasons why international double taxation cannot be removed entirely through bilateral agreements, such as:

- Different effects of treaties on the domestic law of the signatory states,
- Different procedures of enforcement,
- Subsequent changes in tax laws,
- Inadequate information exchange between signatory states.

Conclusion

International double taxation might have harmful effects on the exchange of goods and services as well as movements of capital, technology and people. Although there are several ways to avoid double taxation, one of the most effective ways to be followed may be through the provisions of countries' own tax legislation.

GURULKAN
ÇAKIR

GURULKAN ÇAKIR AVUKATLIK ORTAKLIĞI

Polat İş Merkezi, Offices 28-29
Mecidiyeköy 34387
Istanbul, TURKEY

T +90 212 215 30 00
M info@gurulkan.com
W www.gurulkan.com

Gurulkan Çakır Avukatlık Ortaklığı ("Gurulkan Çakır") is an attorney partnership registered at Istanbul Bar Association with a license number 105 and at the Union of Turkish Bar Associations with a license number 206.

This publication provides general information only and should not be relied upon in making any decision. It is not intended to provide legal or other advice. Gurulkan Çakır and its partners will not be liable for any loss or damage arising from reliance being placed on any of the information contained in this publication.

Before acting on any information, readers should consider the appropriateness of the information provided herein, having regard to their legal and financial status, objectives and needs. In particular, readers should seek independent professional advice prior to making any decision.

This publication may not be reproduced, in part or whole, by any process without prior written consent of Gurulkan Çakır.

© 2019 Gurulkan Çakır Avukatlık Ortaklığı | All rights reserved.