TAXATION OF LIMITED TAXPAYER CORPORATES UNDER THE CORPORATE INCOME TAX LAW

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ABSTRACT

The implementation of tax laws differs in terms of the type of liability. Both the Personal Income Tax Code no. 193 and the Corporate Income Tax Code no. 5520 divides taxpayer's liability into unlimited and limited liability and foresees a number of differences in taxation process. With the effect of globalization, foreign capital investments increase and taxation problems in the international level arise. In this study, taxation process of foreign corporates' incomes and earnings within the scope of limited tax liability and the principles of their taxation regime will be examined within the framework of the doctrine and the legislation.

Keywords: *Limited Tax Liability, Corporate Income Tax, Taxation Process*

KURUMLAR VERGİSİ KANUNU KAPSAMINDA DAR MÜKELLEF KURUMLARIN VERGİLENDİRİLMESİ

ÖZET

Vergi kanunlarının yer bakımından uygulanması mükellefiyet türü açısından farklılık taşımaktadır. Gerek 193 sayılı Gelir Vergisi Kanunu gerekse 5520 sayılı Kurumlar Vergisi Kanunu vergi mükelleflerini tam ve dar olmak üzere ikiye ayırmakta ve uygulamada bir takım farklılıklar öngörmektedir. Küreselleşmenin etkisiyle yabancı sermaye yatırımları artmakta ve uluslarası alanda vergilendirme sorunları ortaya çıkmaktadır. Çalışmada, yabancı sermaye yatırımlarının dar mükellefiyet kapsamında vergilendirilmesi ve tabi oldukları vergileme rejiminin esasları öğreti ve mevzuat çerçevesinde incelenmektedir.

Anahtar Kelimeler: *Dar mükellefiyet, Kurumlar Vergisi, Vergilendirme Yöntemleri*

1. Introduction

States, based on their rights of sovereignty, tax the real persons and the legal entities that operate and generate income within their political boundaries. In this framework the term “territoriality” refers to applying the laws of the state to everybody within the political boundaries of the state; the term “personality”, on the other hand, refers to applying the laws of state to its people (even the citizens who lives outside the state) (Avi-Yonah, 2013:799; Kaneti, 1989: 40).

Today, with the increasing effect of globalization, foreign investors operate in Turkey, while Turkish investors operate in foreign countries. This situation creates problems regarding the taxation of the income generated by these corporations.

The taxation of income within economically originated country defined as the “source principle”. In the tax systems for which the source principle is dominant, the place where income originated is important in taxation. In this system, only incomes originated within the state’s political boundaries are subject to taxation. Due to the difficulties in determining the place where income is originated double taxation can occur when states claim the taxable event take place in their own political boundaries (Green, 1993: 22; Akkaya, 2015: 95; Oktar, 2017: 52).

Under the residence principle, a state’s claim to tax income based on its relationship to a person or to a legal entity such as nationality or residence status (Ekmekçi, 1994: 4).

Regarding to residence status, the domicile of the person is determinant; in terms of the country, that person is under the taxation authority. According to the residence principle, the income that a person obtains from both the country of residence and foreign country taxed by the residence state (Akkaya, 2015: 90).

The main challenge in the application of the residence principle is determining to which country a corporation is under obligation, or in other words, determining a corporation’s head office. In order to resolve this issue, legal head office and business head office criteria applied together in Turkish Tax Laws.

Regarding to nationality status, states determine individuals who have citizenship within their country as taxpayers who are under their authority, and they tax both their domestic and foreign incomes.

Here it is important to note that, if foreign investments realized in Turkey, not only do the Turkish Tax Laws apply but also the international tax treaties taken into consideration. Such that, to prevent double taxation, countries enter into agreement with each other with the aim of protecting their own investors and internal revenue. Today, it is quite clear that tax treaties encourage investments in the international arena.

In this study, after providing general information about taxpayers of corporate income tax, the income of limited taxpayer corporates will be examined within the scope of business income, income from agriculture, independent professional service income, immovable property earning, earnings from capital investment and other income and earnings, and furthermore, the taxation of foreign fund incomes and the determination of the corporate income in foreign transportation corporations will also be examined. Following a brief look at the prevention of double taxation in corporate income tax, in the last part of the study, the process and methods of taxation in limited taxpayer corporations will be examined in the framework of the annual tax return, the special tax return, withholding, and withholding tax return.

2. Tax Liability in Corporate Income Tax

Corporate income tax is a tax levied on the total net incomes of corporations that realize profits from their economic activity (Turhan, 1998:133). Taxpayers of corporate income tax are companies with share capital and other institutions specified by the Law (Bulutoğlu, 2004:36).

While personal income tax levied on the incomes of individuals, corporate income tax levied on the incomes of legal entities. The corporation here refers to a legal entity in the widest sense of the term.

Characteristics of the corporates that will be subject to taxation within the scope of the Corporate Income Tax (CIT) Code regulated and defined in CIT Code Art.1-Art.5.

The subjects of corporate taxpayers per CIT Code Art. 1 are defined as; companies with share capital, cooperatives, joint ventures, public enterprises, and enterprises owned by foundations or associations. Here it is important to emphasize that public enterprises, enterprises owned by foundations and associations, and enterprises owned by foreign public administrations and organizations are subject to corporate income taxation.

The difference between unlimited and limited tax liability in the CIT Code based on whether the legal head office or business head office is located in Turkey. Unlimited liability means corporations that are taxed on

their worldwide income. In order to be tax subject within unlimited liability status, one of the legal or business head offices must be located in Turkey (Oktar, 2016:115; Şirin, 2006:103).

The term 'legal head office' means the head office stated in the main statutes, articles of association or establishment laws of corporations. On the other hand, the term 'business head office' means the center where all economic transactions and operations are concentrated and managed (Oktar, 2016:12; Öncel et al., 2015:336). According to the aforementioned defining criteria, the first (legal head office) is considered "legal" and the second (business head office) is considered "active" criteria (Şirin, 2006:103).

Taxpayers with limited tax liability in the Turkish tax system are only liable for paying taxes on their income obtained in Turkey. Under the limited tax liability, neither the legal head office nor the business head office of the corporate can be in Turkey. Taxpayers with limited tax liability operate and obtain income in Turkey through their business offices or permanent representatives. The incomes that corporations obtain outside of Turkey are not taxed in Turkey (Ministry of Finance, 2007:10).

The tax base that will be subject to taxation in limited taxpayer corporations is the net corporate income obtained in Turkey. However, when taxpayers with limited tax liability obtain income from business and agriculture activities in Turkey, the tax base will be determined, according to the balance sheet principle, as in unlimited liability (Şirin, 2006: 103).

3. Taxable Incomes and Earnings of Limited Taxpayer Corporates

Corporates with limited tax liability, are taxed only on the incomes and earnings obtained in Turkey (in terms of corporate taxation). Otherwise stated, taxation in Turkey depends on the condition that incomes and earnings are obtained in Turkey. This condition takes on different forms according to the type of income or earning (Oktar, 2016:10).

The incomes or earnings that accepted as taxable subjects under limited liability are business income, agricultural income, independent professional service income, immovable property earning, earnings from capital investment and other income and earnings. In addition, the Law includes certain special arrangements regarding the determination of foreign fund incomes and the determination of the corporate income in foreign transportation corporations.

3.1. Business Incomes Obtained by Taxpayers with Limited Tax Liability

Profit is the residual value remaining after expenditures made for the production factors and the raw materials are deducted from the income obtained by the economic unit. From this point of view, profit can be considered as a return for involvement in the production process within furnish of raw materials and integration of them in a production process. In this context, business income is an income earned by independent entrepreneurs (Öncel et al., 2015:261; Bulutoğlu, 2004:13 – 14; Oktar, 2016: 28).

According to Personal Income Tax Code (PITC) Art.37, business income is the profit arising from all types of commercial or industrial activities. Industrial activity refers to a production process wherein substances undergo chemical or physical changes and are processed, transported or stored for supplying customer demands. Simply put, industrial activity is the transformation of resources into products that will meet people's needs. Commercial activity refers to the provision (in terms of place and time) of raw materials, goods or services that are produced to meet people's needs. Services such as banking and advertising for the marketing of products are also included in the scope of commercial activity (Öncel et al., 2015: 261 – 262; Aksoy, 2010: 170; Bulutoğlu, 2004:14).

In taxation, economic activity (commercial and industrial) arises in the form of business income. In economic terms, commercial and industrial activity is the production or supply of goods or services that fulfill people's needs by bringing together one or more factor of production. The concept of business income in PITC is also based on the concept of commercial enterprise. The "commercial enterprise" refers to the economic unit wherein goods and services are produced (Tuncer, 2008).

If we interpret the issue within limited tax taxpayer's liability, incomes obtained by foreign corporates through their business office or permanent representative in Turkey (in accordance with the Tax Procedure Code – TPC) are considered as obtained in Turkey. If the income of limited taxpayer corporates, meet the following two conditions mentioned above, then it is regarded as business income obtained in Turkey and therefore will be taxed in Turkey. In plainer terms, these two conditions are 1-To have a business office or permanent representative in Turkey in accordance with the TPL, 2- To obtain income through this office or permanent representative.

According to the Tax Procedure Code, business offices are the places that allocated for or used for the conduct of commercial, industrial, agricultural or professional activities, such as stores, offices, executive offices, clinics, entertainment and sports venues, fields, vineyards, gardens, farms, animal husbandry facilities, fisheries, mines, quarries, construction sites, canteens (Oktar, 2016: 10).

The permanent representative is the person authorized to carry out business transactions on a permanent basis for a certain period or for an indefinite period on behalf of and on account of the person represented by service or attorney agreement (Oktar, 2016: 10).

Commercial agents, merchants' representatives and officials, or agencies whose expenses (excluding advertising expenses) are paid consistently by the represented, persons permanently holding goods for sale through consignation to their represented account in the store or warehouse shall be deemed to be permanent representatives without regard to any other conditions (Oktar, 2016: 10).

In the Corporate Income Tax Code, there is an exception regarding the business income obtained in Turkey for limited taxpayers. If limited taxpayers deliver their goods bought in Turkey to foreign countries (without selling them in Turkey -with the aim of export-), the incomes are not considered to be obtained in Turkey. The condition requiring that taxpayers deliver the goods they buy in Turkey for export means that the buyer or seller or both are in Turkey or that the sales contract is made in Turkey (CITC Art.3-a). In other words, in order to benefit from this exception, limited taxpayers must buy the goods in Turkey in order to export, must export these goods without selling them in Turkey, and earn an income from this transaction. The aim of this exception is to find new markets through foreign corporates, to expand the volume of export and to increase the inflow of foreign exchange.

3.2. Agricultural Income Obtained by Taxpayers with Limited Tax Liability

Income obtained from natural-biological resources are characterized as agricultural income. Agricultural income in PITC Art.52 is defined according to agricultural activity. In PITC, agricultural activity means any activity performed on land, sea, lakes or rivers that involves cultivating, planting, animal husbandry, production, growing and breeding, hunting, protection by hunters and by planters, cleaning and transporting, selling or other utilization of plants, forests, animals, fish and fish products or any activity that directly benefits from nature. The activities where there is ambiguity regarding their characteristics are counted as agricultural activity if it is identified in the PITC Art.52 and 53.

If the agricultural activity is realized in an enterprise, the income from this activity is considered as business income. In cases where an agricultural activity reaches the size of the industrial production, the income from this agricultural activity should also be considered as business income. As this boundary between agricultural and industrial activity involves uncertainty, the key point is to determine whether the scale of production reaches the size of industrial production or not (Kaneti, 1989:326; Bulutoğlu, 2004:39; Öncel et al., 2015: 282; Oktar, 2016:44).

In order to be characterized as an agricultural income obtained in Turkey, it is necessary that the agricultural economic unit (business office) must be located in Turkey and that the income must be derived from the operations of this economic unit (CITC Art.3-b).

In this framework, the agricultural income of limited taxpayers should be reported as business income. This is because, if limited taxpayer corporation have an economic unit (business office) in Turkey then it can able to earn agricultural income in Turkey. Otherwise stated, a limited taxpayer should have a business office, and agricultural activities must be carried out in this office. Therefore, agricultural income on account of the business office condition required for business income will be reported as business income; it is unlikely that a foreign corporate would be able to obtain agricultural income in terms of PITC and CITC in Turkey.

Here it is important to note that in Article 6 of the OECD Model Tax Convention, which forms the basis of treaties aimed at preventing double taxation, agricultural and livestock incomes (correspond to incomes from agricultural activities in Turkish tax system) are included in the income derived from immovable property, and the taxation authority is granted to the state wherein the agricultural activities of taxpayers are situated (OECD, 2014. 28). However, when the legislation in force in Turkey is taken into consideration, the incomes derived from the agricultural activities of limited taxpayers are accepted as business incomes.

3.3. Independent Professional Service Income Obtained by Taxpayers with Limited Tax Liability

An activity gains independent professional service character when the capital factor is added to a qualified labor. However, to be accepted as independent professional service income, the income must not carry

business income qualifications. In other words, the contribution of the capital factor in the economic activity should not outweigh the labor factor (PITC art.66; Kaneti, 1989: 328 – 329; Bulutoğlu, 2004:57 – 58; Öncel et al., 2015:296).

Independent professional service income is defined in Article 65 of the PIT Code. According to this article, all incomes derived from independent professional services are characterized as independent professional service income. In Article 66 of the related Code, independent professional service activities are listed.

If taxpayers with limited tax liability obtain independent professional service incomes, the provisions of the PIT Code will be applied in determining the corporate tax base. In this context, the independent professional service incomes obtained by limited taxpayers will be determined according to Article 7 of the PIT Code. According to this provision, if the independent professional service activity is executed or evaluated in Turkey then the independent professional service income will be accepted as obtained in Turkey.

Even the benefits derived from the independent professional service activities be outside of Turkey, if the independent professional service activity is executed in Turkey, the income is still considered as earned in Turkey. For example, if an engineering company with limited tax liability is given lead of a project that is executed in Turkey from an international agency, regardless of who benefits from the project (i.e. a different country), income is deemed to have been earned in Turkey and is therefore will be taxed in Turkey (Öncel et al., 2015: 260).

In the Turkish Tax Law system, measures for determining whether independent professional service activity has been carried out or in Turkey are not clear. Therefore, if the independent professional service activity starts in a foreign country and ends in Turkey or vice versa, various problems may arise in the determination of whether the independent professional service income can be regarded as having been obtained in Turkey or not. In decisions of the Conseil d'État, this problem is solved on the basis of where the main activity is carried out. According to this approach, if the country where the activity of an economic unit predominantly takes place is Turkey, the independent professional service incomes are considered to be obtained in Turkey[1] (Ekmekçi, 1994: 54-55).

The criteria that the independent professional service activity is evaluated in Turkey means that the payment of the activity is made in Turkey, or in the case that the payment of the activity is made in a foreign country, the payment should have been transferred to the taxpayer's account in Turkey.

3.4. Earnings Obtained by Limited Taxpayers from the Lease of Real (Immovable) Property and Rights

In the case that capital in the form of immovable property is used in the production process for a commercial purpose, the income obtained is characterized as business income. When the capital in the form of immovable property is not directly involved in the production process, but rather, income is generated because of the lease of the property, this income is generally called rental income. The income obtained in this way is accepted as immovable property earning (Öncel et al., 2015:301). Immovable property earning is defined in Art. 70 of the PITC.

In the immovable property earnings, there is an economic benefit (value) sourced from leasing of an immovable property or a right to others (Bulutoğlu, 2004: 61).

For limited taxpayers the rental income obtained by the lease of the immovable property or rights will be subject to taxation in Turkey in the existence of two separate conditions. First, the immovable property must be located in Turkey. Secondly, the immovable property or the right must be used or evaluated in Turkey (PIT Code Art.7/4; Ekmekçi, 1994: 62-63).

If payments take place in Turkey or in a foreign country and are transferred to the accounts in Turkey on behalf and account of the receiver or assigned from the profit of the payer in Turkey this means that the immovable property or the right is evaluated in Turkey. In this case, the earning is accepted as been obtained in Turkey.

If the immovable property or the right is located in Turkey, then the rental income is accepted to be obtained in Turkey. In this context, if the use of rights (such as patents, licenses, know-how and similar rights) is in Turkey then the income derived from these rights will be accepted as obtained in Turkey.

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[1] See for the decisions of the Conseil d'État: Conseil d'État 4th Chamber P: 1977/1454, D: 1977/3303 and Conseil d'État 4th Chamber 1982/4400, D. 1984/1544 (http://emsal.danistay.uyap.gov.tr)

3.5. Earnings from Capital Investment Obtained by Taxpayers with Limited Tax Liability

Earnings from capital investments are incomes obtained from financial investments, such as mutual funds, stocks, bonds or equity shares etc. In the scope of incomes from capital investment, a benefit (income) is obtained from financial capital without any direct involvement in a production process. Although it is very similar to the immovable property earnings in this respect, it is different from immovable property in that it involves the concept of exclusivity. If the exclusivity of the financial capital is transferred in the form of loan as a debt, it is defined interest income, and if it is transferred in the form of share of interest, it is defined as dividend income (Kaneti, 1989: 331; Bulutoğlu, 2004: 62; Öncel et al., 2015: 308; Oktar, 2016: 66).

In the economic relation mentioned above, individuals obtain income (benefit) by lending their financial capital, without directly involving in the production process. In this context, interest income is earned from the lending and dividend income is earned in the case of associating within passive participation in the production process. Both earnings are classified as earnings from capital investment. In Art. 75 of the PIT Code; the types of taxable earnings from capital investments are listed (Bulutoğlu, 2004:66; Öncel et al., 2015: 308).

To be taxed in Turkey, financial capital must be invested in Turkey. The Law does not cover the criteria for "being invested" in Turkey. Nonetheless, it can be presumed that the capital invested in Turkey has expressed utilization or evaluation in Turkey (Başak, 2007:1552).

Securities are deemed as being invested or evaluated in Turkey in the following cases: capitalization to an enterprise in Turkey, loans issued in Turkey in the form of debt or credit, investments made as a deposit or investment account in a bank in Turkey, and similar situations. In other words, in cases where there is the accretion of capital in Turkey or the evaluation of money in Turkish capital markets, the returns obtained due to these capitals will be considered as being obtained in Turkey (Safoğlu, 2007:187).

3.6. Other Incomes and Earnings Obtained by Taxpayers with Limited Tax Liability

Other incomes and earnings are incomes that cannot generally be attributed to the six revenue items (these are; salaries and wages, business income, income from agriculture, independent professional service income, immovable property earning, earnings from capital investment) listed in the PIT Code.

Within the scope of other incomes and earnings, income is determined on the basis of net income theory (Oktar, 2016:3). Regarding other incomes and earnings, the boundary of the concept of income from the source theory to the net income theory is determined in the Law. In this framework, other incomes and earnings must be clearly defined and ordered by the Law (Bulutoğlu, 2004:75; Öncel et al., 2015: 312; Oktar, 2016: 71).

Other incomes and earnings are divided into two groups: capital gains and non-recurring incomes.

Incomes from the sale of the capital market instruments or rights specified by the Law are considered as capital gains. These incomes are irregular incomes. They are not periodic income sources, unlike dividends and interests, but rather, they largely arise from the sale of financial assets (Kaneti, 1989: 332 – 333; Bulutoğlu, 2004:75; Öncel et al., 2015: 312; Oktar, 2016:72).

Non-recurring incomes are incomes that can be obtained by the first six income activities with the difference being that they are temporary or not done in a continuous manner.

In terms of limited tax liability, in order to be accepted as other incomes and earnings obtained in Turkey, economic activity or transaction must be executed or evaluated in Turkey. The fact that it is executed or evaluated in Turkey is the existence of the will to operate in Turkey as an intention. As an example, let's say an invention document, held by a person who is a resident outside of Turkey, is purchased by a company in Turkey and the payment is made in Turkey. Since the benefit is held in Turkey then the incomes generated from this transaction will be subject to taxation (in limited tax liability) in Turkey (Özbalcı, 2002:126).

3.7. Taxation of Foreign Fund Incomes

The incomes of foreign funds obtained from financial transactions carried out by taxpayers with full liability who are recognized as portfolio managers by the Capital Markets Boards of Turkey shall not be declared under the following conditions: (CITC, Art.5/A):

i. The transactions carried on behalf of the fund shall be included among the ordinary activities of the company which performs portfolio management;

ii. Considering the commercial, legal and financial characteristics of the company performing portfolio management, the relationship between the foreign fund and company must be the same as the one that exists for those who operate independently from each other, in compliance with the arm's length principle;

iii. The fees for services provided by the portfolio management company must be appropriate to the arm's length principle and transfer pricing report should be given to the Ministry of Finance Revenue Administration within the declaration period of the corporation tax;

iv. The portfolio management company and the persons related with the company should not have more than 20% right to claim (directly or indirectly) on foreign fund incomes after deducting the service fee.

The incomes of foreign funds, which meets the conditions indicated above, are exempt from the corporation tax[2]. However, if the portfolio management company and the persons related with the company have more than 20% right to claim on foreign fund incomes, the corresponding amount of the foreign fund incomes will be taxed according to the general taxation provisions.

3.8. Determination of the Net Income for Foreign Transportation Corporations

The corporate income tax base for foreign transportation corporations is calculated through the application of the average revenue ratio to their revenues. The average revenue rates for all foreign transportation corporations in Turkey (regardless of whether their economic activities are permanent or temporary) are 12% in road transport, 15% in maritime transport, and 5% in air transport (CITC Art.23).

The income of foreign transportation corporations in Turkey, which are taxed within the scope of business income under limited liability, consists of the following elements:

i. In road transport taking place within the political boundaries of Turkey, the fees charged with the ticket price (fees received by foreign transportation corporations regardless of the name such as passengers, freight and baggage handling fee).

ii. In maritime and air transport from the loading port in Turkey to the port of the destination in a foreign country; the fees charged with the ticket price (fees received by foreign transportation corporations regardless the name such as passengers, freight and baggage handling fee).

iii. Fees of passenger and baggage tickets sold in Turkey on behalf of other transportation corporations activities outside Turkey. Commissions and fees given to other transportation corporations outside Turkey due to the freight contracts they have made in Turkey.

4. Prevention of Double Taxation in Corporate Income Tax

According to Yaltı (1995:3), double taxation occurs, if more than one same kind tax is levied on the same taxpayer and the same tax base within the same taxation period due to the coincidence of taxation authorities of more than one state or the use of the same authority several times.

For example, double taxation occurs when a corporate income is taxed in country A in the framework of corporate taxation, while the same corporate income also taxed in Turkey in the framework of corporate tax during the same tax period. In this respect, treaties to prevent double taxation are important for limited taxpayers. In order to prevent double taxation, Turkey has signed several international tax treaties with other countries (Batırel, 1990: 45).

Double taxation violates tax fairness and equity. Furthermore, as a cost factor, double taxation affects decisions of foreign capital about country preferences. Capital under profit maximization purpose takes into account the tax burden while determining the countries to invest (Turan & Yücel, 1999:45; Freedman, 2000:322).

Since the deduction of the taxes paid abroad by unlimited taxpayers is possible within the provisions of the PITC and the CITC, international double taxation is generally not an issue for them. However, for corporations and individuals with limited tax liability operating in Turkey, there is the possibility of face off

[2] Immovable property in Turkey, company's share of the property that is more than 51% of the assets, or shareholdings of futures and options contracts related to them, futures and options contracts based on commodities other than those resulting in compromise of cash, and insurance contracts and their gains derived from futures and options contracts are not included within the scope of this exception.

against double taxation. In this respect, Turkey is party to eighty-two (82) international treaties to prevent double taxation, in order to eliminate the problems associated with double taxation[3].

Treaties to prevent double taxation essentially prevent the taxation of income in both countries (residence or source) by regulating the taxation of income only in residence or source country or sharing the right of taxation between the two countries (Kane, 2015: 312; Tuncer, 2007:8).

5. Methods of Taxation for Limited Taxpayer Corporates

Tax assessment in the Turkish tax system is based on the declaration principle. This principle also shows itself in corporate income taxation. The methods of declaration principle in taxation process of limited taxpayer corporates differ according to the type of incomes or earnings.

There are three different declaration methods for limited taxpayer corporates within the scope of corporate taxation, and these are discussed below. These declaration methods are annual tax return, special tax return and withholding tax return.

5.1. Annual Tax Return on Corporate Taxpayers with Limited Tax Liability

The annual tax return is the main method used to declare the taxable income of corporations with unlimited and limited tax liability. According to Art.24 of the CIT Code, the corporate income tax is levied on the declaration of the taxpayer or responsible party. Declaration includes the economic results of the relevant accounting period (Şenyüz et al., 2012: 194).

Limited taxpayer corporations that obtain business or agricultural income in Turkey will be taxed on the basis of their annual tax return. The declaration process of the business or the agricultural incomes obtained by the limited taxpayer corporations are similar to those required by corporations with unlimited tax liability.

5.1.1. Situations Where the Annual Corporate Income Tax Return is Required

The incomes from the activities of the non-resident corporations through their business offices or permanent representatives in Turkey are regarded as business incomes obtained in Turkey. Therefore, limited taxpayer corporations who are engaged in commercial and agricultural activities in Turkey are required to submit annual corporate income tax return.

It is obligatory to include in the annual return the incomes and/or earnings obtained in connection with the business offices. In other words, the income and earnings must be included in the annual tax return since they are obtained within the business offices (Özbalcı, 2002:578).

All incomes and earnings (excluding business incomes, agricultural incomes and other incomes and earnings) which are not taxed by withholding methods must be declared in the annual tax return.

On the incomes and earnings that are declared through the annual return the rate of the corporate income tax is 20%.

Tax return must be submitted by the first day until the evening of the twenty-fifth day of the fourth month following the month of the end of the accounting period. This statement has been ensured in Article 21 of CIT Code, which does not make any difference from unlimited tax liability status.

5.1.2. Situations Where Declaration of Corporate Tax Return is Optional

According to Art.30 of the CIT Code, in cases where incomes are obtained without being engaged in commercial or agricultural activity in Turkey and are taxed by withholding methods, the declaration of such incomes and earnings by annual or special return is left to the discretion of the limited taxpayers. If these incomes and earning are declared then the taxes levied by withholding method can be deducted from the corporate tax calculated on the annual tax return (Turan & Yücel, 1999: 454; Tekin, 2008: 104).

[3] To see these treaties: http://www.gib.gov.tr/sites/default/files/uluslararasi_mevzuat/vergıanlasmalıst.htm

5.1.3. Non-Taxable Business Incomes of Taxpayers with Limited Tax Liability

According to Article 3/3-a of the CIT Code, if goods that are bought in Turkey by limited taxpayer corporates are exported without being sold in Turkey, the incomes are not considered to be obtained in Turkey. These incomes will not be subject to taxation in Turkey.

5.2. Special Tax Return on Corporate Taxpayers with Limited Tax Liability

If the taxable income of limited taxpayer corporates consists of other incomes and earnings specified in Art. 80 of the PIT Code, the foreign corporates must declare these incomes and earnings to the tax offices within fifteen days from the date of obtaining them. In this framework, capital gains and non-recurring incomes of taxpayers with limited tax liability must be declared by special tax return.

The declaration of the other incomes and earnings obtained by limited taxpayer corporates through a special tax return is an arrangement for securing tax claim. In general, the taxation is made during the accounting period in cases where foreign institutions have business or agricultural activities in Turkey, while other incomes and earnings are taxed immediately (within 15 days). Tax security is provided by the application of the special tax return method as it imposes immediate (within 15 days) taxation (Vural, 2015: 239).

5.3. Withholding Tax and Withholding Tax Return for Taxpayers with Limited Tax Liability

The following incomes and earnings will be taxed by withholding method and they are subject to a 15% corporate income tax cut.

Limited taxpayer’s incomes from independent professional services, immovable capitals, capital investments and progress payments for long-term construction and repair projects.

The incomes from sale and transfer of intangible rights, such as copyright, patent, invention, operating, trade name, trademark and so forth.

Profit shares paid by unlimited taxpayer corporates to limited taxpayer corporates.

Incomes from commercial activities in exhibitions and fairs by taxpayers with limited tax liability who do not have a business office or permanent representative in Turkey.

The 15% withholding tax rate is also imposed on the transfers to the headquarters from the income obtained by limited taxpayers who submit annual and special tax return.

Besides these incomes and earnings, 30% withholding tax rate is imposed on payments made to the institutions established or operating in the countries declared by the Council of Ministers. The Council of Ministers will declare these countries by considering whether the country’s tax system (where the incomes are obtained) provides a taxation opportunity at the same level as the taxation capacity of the Turkish tax system, and by considering the exchange of information with these countries. However, any country in this regard has not been already declared by the Council of Ministers.

The Council of Ministers is authorized to determine separately the withholding tax rates for each income element or activity above and to reduce the withholding tax rates to zero or to increase the rates by one hundred percent.

On the other hand, there is no withholding tax on the principal, interest and dividend payments or on insurance and reinsurance payments related to the borrowings obtained from foreign financial institutions.

The payers of such incomes will realize the withholding taxation. Those who are required to realize withholding taxation according to Art. 30 of the CIT Code must pay these taxes and declare them with a withholding tax return.

Corporates that are required to submit an annual return due to their business or agricultural income in Turkey can also earn income subject to withholding tax. If the subject of withholding tax is not related to a commercial or agricultural acitivity limited taxpayers can choose at their own discretion whether to declare these incomes through their annual tax return. In the case that, the incomes subjected to withholding tax are included in the annual tax return, the withholding tax (realized and paid by the payers of such incomes) can be deducted in the annual tax return.

6. Conclusion

States (based on their right of sovereignty) are taxing real persons and legal entities who operate and generate income within their political boundaries. To apply the Laws of the state to everybody within its political boundaries is called "territoriality". On the other hand, to apply the Laws of the state to its citizens whether they are in the political boundaries or not is called "personality".

Today, with the increasing effect of globalization, foreign investors operate in Turkey and Turkish investors operate in foreign countries. Under these circumstances, source and territoriality problems occur related to the taxation of foreign corporates income. As discussed in detail, incomes from business, agricultural and other activities of foreign corporates in Turkey are taxed on the basis of limited tax liability.

The incomes of unlimited taxpayer corporates are taxed on the basis of business incomes. Unlike unlimited tax liability, the taxation process of limited taxpayer corporates actualizes depending to the type of income and earnings. For example, the rental income obtained in Turkey by limited taxpayers is characterized as immovable capital income, not as a business income. Nevertheless, all the incomes obtained by limited taxpayers who have business offices or permanent representatives are characterized as business incomes.

The tax rules that states determine independently from each other can sometimes result the taxation of the same taxpayer twice over the same tax base within the same taxation period. In order to prevent this situation, which is referred as "double taxation", states engage into international treaties and take preventive measures in their tax legislation. These regulations apply to both real persons and legal entities.

If we look at the taxation rules concerning limited taxpayers in the Turkish income tax system in general terms, it can be seen that the criteria related to characterization of independent professional service activity and characterization of capital invested in Turkey are not clear enough. On the other hand, this situation is clarified through case law of the Conseil d'État and interpretation techniques. However, these areas of the Tax Law need to be regulated in such a way that the legality principle plays a more dominant role.

During the process of acquisition of income, the country in which the economic activity took place and in which headquarter is located is determinant. In so far as both the source country and country of residence may make tax claims on income of the taxpayer. It is here that the problem of double taxation can emerge. It is possible to accept the concept of limited tax liability as a tool to prevent international double taxation, but in practice, it is very difficult to identify limited taxpayers who obtain income from independent professional service.

In general, in the taxation of limited taxpayers, in addition to annual return, withholding tax and special tax return methods are also applied, so the payers of such incomes report the taxable income to the tax office. By the declaration of the taxable income (by special tax return method) in a short period after it is earned can realize a greater tax security on the behalf of the state.

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