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Subject: Recent Developments Regarding the Taxation of the Income derived from the Professional Services Performed by Non-Resident Enterprises in Turkey.

The Double Tax Treaty General Communique Serial No.4 was published in the Official Gazette on **September 26, 2017** and entered into force on the same date and abolished the former communique Serial No. 3.

The said Communique provided detailed explanations about the taxation of the income of the non-residents (both real persons and legal persons (enterprises)) derived from their independent professional services (and such services with a similar nature) performed in Turkey. The explanations provided in the Communique also signal that the ongoing perception of the Turkish Revenue Administration ("**TRA**") has changed on some critical points.

Under Article 65 of Income Tax Code, the nature of independent professional services is defined as the conduct, without being subject to an employer, and under one's own personal responsibility and in one's own name and on one's own behalf, of work which is not of a commercial nature and which is rather dependent on personal effort; practical or professional knowledge or specialization than the capital. On the other hand, the legal persons (enterprises) may derive income from such services through their employees.

Under the current Income Tax and Corporate Tax Codes, the payments made in return for an independent professional service rendered is, in general, subject to **20%** withholding tax ("**WHT**") deduction. The said WHT deduction applies when the service provider is a non-

resident real person or a non-resident legal person (enterprise without a permanent establishment or a fixed base in Turkey), provided that such services are performed in Turkey or they are accounted for in Turkey.

The highlights of the said Communique will be summarized below with regards to the cases where the independent professional services are performed by **non-resident legal persons (enterprises**);

1) Which Articles of the Double Tax Treaties will be primarily considered for the Determination of the Taxation Right of the Countries?

The double tax treaties that are signed by Turkey are grouped into **5 categories** with regards to how each regulates the taxation base of the income derived from independent professional services.

First Group of Treaties; while the definition of "**a service Permanent Establishment (a service PE)**" is provided under **Article 5**, **Article 14** regulates the taxation of income derived from the independent professional services that are performed by the "**residents**" of the other contracting State. Accordingly, based on the scenario that the professional services are performed by the non-resident legal persons (enterprises), the conditions of **a service PE as set forth under Article 5** will be considered and provided that the conditions are satisfied, the income from such activities will be taxed as per **Article 7** which regulates the taxation of business profits.

Second Group of Treaties; while the definition of "**a service Permanent Establishment (a service PE)**" is provided under **Article 5**, **Article 14** regulates the taxation of income derived from the independent professional services that are performed by the "**resident real persons**" of the other contracting State. Accordingly, based on the scenario that the professional services are performed by the non-resident legal persons (enterprises), the conditions of **a service PE as set forth under Article 5** will be considered and provided that the conditions are satisfied, the income from such activities will be taxed as per **Article 7** which regulates the taxation of business profits.

Third Group of Treaties; while the definition of "**a service Permanent Establishment (a service PE)**" is **not** provided under **Article 5**, **Article 14** regulates the taxation of income derived from the independent professional services that are performed by the "**resident real persons**" of the other contracting State. Accordingly, based on the scenario that the professional services are performed by the non-resident legal persons (enterprises), the

general conditions of **a PE as set forth under Article 5** will be considered and provided that the conditions are satisfied, the income from such activities will be taxed as per **Article 7** which regulates the taxation of business profits.

Fourth Group of Treaties; while the definition of "**a service Permanent Establishment (a service PE)**" is **not** provided under **Article 5**, **Article 14** regulates the taxation of income derived from the independent professional services that are performed by the "**residents**" of the other contracting State. Accordingly, based on the scenario that the professional services are performed by the non-resident legal persons (enterprises), the general conditions as provided under **Article 14** will be considered in determination of the taxation rights of the States.

Fifth Group of Treaties; while the definition of "**a service Permanent Establishment (a service PE)**" is **not** provided under **Article 5**, **Article 14** regulates the taxation of income derived from the independent professional services that are performed by the "**resident real persons**" and "**resident enterprises**" of the other contracting State. Accordingly, based on the scenario that the professional services are performed by the non-resident legal persons (enterprises), the specific conditions as provided under **Article 14** for the enterprises will be considered in determination of the taxation rights of the States.

Based on another example given in the communique, it is understood that in the tax treaties in which the definition of "**a service Permanent Establishment (a service PE)**" is provided under **Article 5**, while **Article 14** regulates the taxation of income derived from the independent professional services that are performed by the "**resident real persons**" and "**resident enterprises**" of the other contracting State, **Article 14** will be primarily considered in the determination of the taxation right of Turkey.

2) What Factors in the Double Tax Treaties determine the Taxation Right of Turkey?

As per Article 7 of the Income Tax Code, the income of the non-resident service provider derived from the independent professional services **is earned in Turkey** provided that such services are performed in Turkey **or** the payments in return for such services are accounted for in Turkey. Accordingly, such income of the non-resident service provider that is earned in Turkey is subject to taxation in Turkey as per the Turkish tax regulations.

On the other hand, under the tax treaties that Turkey signed with other countries, it is understood that Turkey is given the right of taxation based on **the three main factors** as below;

-**Permanent Establishment or a Fixed Base:** The activity is performed through a PE or a fixed base in Turkey,

- **The length of presence:** The length of presence of the non-resident service provider lasts for a certain period of time, i.e. more than 6 months/183 days or more than 183 days in a calendar year/fiscal year or an uninterrupted period of 12 months.

-**The remuneration is paid in Turkey:** The remuneration in return for services is paid by a resident of Turkey or in the name of such person or through a permanent establishment/fixed base in Turkey,

3) ***What Does the "Fixed Base" in the Tax Treaties mean for the Non-Resident Enterprises?***

In general, the concept of "**a fixed base**" that is used for the real-persons is similar to the concept of "**a permanent establishment**" that is used for the legal persons and whether or not a fixed base is constituted for a non-resident legal person shall be determined as per the general conditions specified under Article 5. For a fixed base to be deemed to be constituted, the services are not required to be exclusively performed in these places. Additionally, whether or not the fixed base is shared with other parties or it is legally owned by others will not make any difference in the analysis.

4) How Will the Length of Presence (duration of stay) in the Tax Treaties be determined for the Non-resident Enterprises?

Under some tax treaties, in addition to the permanent establishment/fixed base criteria, the criteria of the length of presence (duration of stay) of the non-resident enterprise in Turkey is also considered. In other words, if the non-resident service provider does not have a permanent establishment/fixed base in Turkey however, the services require the service provider to be present in Turkey for some time, the length of presence of the service provider in Turkey may play a vital role in determination of the taxation right of Turkey. Accordingly, whether or not the services performed by the non-resident enterprises in Turkey last for 6

months or 183 days or longer than 183 days in any uninterrupted period of 12 months/ a calendar year/a fiscal year shall be considered.

On the other hand, for those non-resident service providers who perform services in the nature of independent professional services through their existing Turkish PEs, Turkey will exert its taxation right over the income that is attributed to such PE, regardless of the length of presence of the non-resident in Turkey.

In cases where the tax treaty does **not** specifically regulate the taxation right of Turkey over the income derived from independent professional services under either Article 5 or Article 14, then Turkey's taxation right as the source country will be determined as per the general conditions as set forth under Article 5 of the treaty in connection with Article 7.

5) Critical Changes in the ongoing view of the Turkish Tax Authority and Other Explanations Regarding the calculation of the Length of Presence (Duration of Stay) of the Non-Resident Enterprise in Turkey

- The tax treaties under which the length of presence of the non-resident in Turkey is defined as "exceeding 6 months in any uninterrupted 12-month period/ a calendar year/ a fiscal year", if the services are performed at intervals, the 6-month criteria will be computed as taking each month as 30 days in the calculation and thus if such services last for more than 180 days, Turkey will have the right to tax such income. However, if the services continue without any interruption, the 6-month period will be assumed to be completed on the date that corresponds to the day in the 6th month of the starting date of the service. In case, there is no corresponding date of the starting date after 6 months, 6-month period will be assumed to be finalized at the end of the 6-month period. Thus, if the services last for more than 6-month period, Turkey will have the right to tax such income
- Based on the ongoing view of the TRA, the length of presence (duration of stay) of the non-resident service provider in Turkey has been determined on the cumulative basis whereby the number of days spent in Turkey by each individual/employee has been added up. For example, if a non-resident service provider performs its services in Turkey through its 10 employees who are each present in Turkey for a period of 20 days, the presence of the non-resident service provider in Turkey has been counted as 200 days, i.e. through multiplying the number of days with the number of individuals and adding up the days to conclude the duration of stay of the non-resident in Turkey in the aggregate. Accordingly, with this ongoing approach of the TRA, it has been rather easy and quick to

satisfy the minimum required length of presence of the non-resident service provider in Turkey, whereby the taxation right of the income derived from such professional services is given to Turkey. The aforementioned deviating approach of the TRA from the general principles of the OECD commentary has been frequently questioned/ challenged by most of the non-resident service providers/investors into Turkey. With the promulgation of the said Communique Serial No.4, it is understood that the TRA has changed its interpretation in this regard. As explained in the Communique, **as from the date the Communique entered into force**, the presence of the non-resident service provider in Turkey will be computed based on their presence in Turkey regardless of the number of the individuals/employees who are present in Turkey to perform such activity. For example, if 10 employees are in Turkey for a period of 20 days to perform the services, the presence of the non-resident enterprise in Turkey will be counted as 20 days.

- The communique also provided detailed explanations with regards to the definition of **"a same or a connected Project".** For the calculation of the length of presence of the non-resident service provider enterprise in Turkey, the "**Same Project**" should mean the same Project for the service provider. For example, the services performed for different branches of a Turkish Company will be considered "a same Project" in this respect. The service provider enterprise may perform its services to the same individual or the company, or to different persons.

- On the other hand, "**a connected Project**" shall mean the services that are performed under different Projects but that are commercially integrated. The evaluation of whether or not the Projects are connected should be made based on the merits of each case, whereby the below conditions shall be considered;

- Whether or not the Projects are covered under the same Master Agreement,

- In cases where the Projects are covered under different agreements, whether or not such agreements are concluded with the same or related persons and whether or not it can be envisaged that the other agreements will be similarly concluded upon the signing of the first agreement,

- Whether or not the qualifications of the works performed under different Projects are same/similar,

- Whether or not the services under the scope of different Projects are performed by the same individuals,

- The length of presence of a non-resident service provider enterprise shall be determined in the aggregate with regards to the services performed under the same or connected Projects, whereas such presence will be determined separately for each different Project.

- In the absence of “a same or a connected Project” expression in the relevant tax treaties, the length of presence is understood to be determined in the aggregate considering the total time spent to perform services in Turkey for each and every Project regardless of the number individuals.

- On the other hand, as a general rule, it is stated in the Communique that if several services are performed in Turkey together within the same period of time, the presence of the non-resident service provider in Turkey shall be determined by counting each day that the service provider is physically present in Turkey where the number of overlapping days are considered once to avoid duplication. In this framework, an example is provided where the services are performed in Turkey by a non-resident real person (not an enterprise), and his duration of stay in Turkey is computed by considering each day spent in Turkey, whereby the overlapping days are counted once in the calculation. However, whether or not the same principle will similarly apply in the case of non-resident enterprises is not explicitly mentioned in the communique and we note that further clarifications by the Revenue Administration is required.

6) The Validity of the Certificate of Residence of the Non-Resident Service Provider

The certificate of the residence of the service provider that belongs to a calendar year will be valid until the fourth month of the following year.

7) *Is It Sufficient for Taxation in Turkey on the Grounds that the Taxation Right Is Granted to Turkey Under a Tax Treaty?*

The taxation right granted to Turkey under a tax treaty can only be effectuated through the taxation and legislative principles taking place in the Turkish tax codes. In other words, it is not sufficient for an income of a non-resident to be taxable in Turkey merely on the grounds that Turkey holds the taxation right of such income as per the relevant tax treaty, but the local tax rules are also required to take place in the Turkish tax legislation.

8) *The Bindingness of a Classification of an Income Under a Tax Treaty*

The classification of an income under a tax treaty with regards to the determination of the taxation right among the relevant treaty countries is not binding on the taxation of such income under the local Turkish tax legislation. The income that is classified under a certain income

type as per the tax treaty may be classified differently under the local tax legislation. For example, in cases where an enterprise is performing services and such services are not specifically mentioned in the treaty and thus the taxation right is given to Turkey as per the general rules mentioned under Article 5 and followed by Article 7, i.e. business profits, depending on the qualifications of such services, Turkey may still exert its rules applicable for taxation of income from independent professional services. Accordingly, in cases under which the independent professional services are mentioned under Article 5 within the definition of " a service enterprise" (and whereby such service income shall be taxed as per Article 7-Business Profits of the tax treaty) and based on the assumption that the conditions of a service PE are fulfilled and consequently, Turkey is given the taxation right of such service income. In this respect, in the absence of a registered PE in Turkey, Turkey shall still tax such income of the non-resident service provider from independent professional services through **the deduction of withholding tax**, i.e. as aforementioned, the income of non-resident service providers derived from independent Professional services is subject to 20% WHT as per the current Turkish tax legislation.

9) ***The Forms that are introduced by The Communique and that will be submitted to the Tax Office***

Under the following conditions, the resident service recipient will not deduct any withholding tax over its payments made to the non-resident service provider in return for the Professional services;

- Services are not performed in Turkey,

- Services are not associated with any intangible rights,

- Services are performed in Turkey, however Turkey does not hold the taxation right as per the relevant tax treaty,

However, the non-resident service provider enterprise will still be required to fulfill **Form No. 1** that is attached to the Communique and will be required to submit the Form to the resident service recipient within 30 days as from the date the services are started. Contrary with this explanation, under Section **4.2.2.1 – The Performance of Services Without Any Presence in Turkey** of the Communique, it is mentioned that Form No.1 and No.2 will not be required to be completed. As such, further clarification by the TRA should be expected in this matter. The following information is required to be provided by the non-resident service provider under Form No.1;

- Information regarding the service provider,

- Information regarding the services performed,

- Information regarding the services performed in the past and the services that will be provided in the future,

Additionally, **Form No.2** that is attached to the Communique will be completed by the service recipients (tax responsible) and will be submitted to the tax office together with Form No.1 and the Services Agreement, if any. In cases where the service recipient makes partial payments in return for the services, both Form No.1 and Form No.2 will be required to be submitted to the tax office prior to the initial payment. In cases where several services are received and which are not subject to withholding tax, the resident service recipient will be required to complete Form No.2 and this form will be required to be submitted to the tax office together with the list of the names of the service providers who completed **Form No.1. Form No.2** will provide the payment details made in return for the services received and also declaration of the service recipient (tax responsible) that the information provided in Form No.1 is correct.

10) The Corporate Withholding Tax Deduction over Payments made in previous periods

If changes, such as the service period is extended, a PE/fixed base is registered and the income is attributed to such a PE/fixed base etc., take place during the performance of the services and accordingly, Turkey becomes entitled to tax such service income, the service recipient as the tax responsible, will retrospectively be required to deduct withholding tax over its payments for such services.

11) ***In Cases where Turkey's Taxation right cannot be determined at the Beginning of the Services***

Regarding the services to be performed in Turkey, in cases where the presence of the non-resident service provider enterprise in Turkey cannot be clearly identified at the time of signing the services contract or at the time of payment or it cannot be clearly identified whether or not Turkey's taxation right is constituted, the service recipients will be required to deduct withholding tax over their payments to non-resident service providers.

12) ***The Refund of the Withholding Tax That Is Redundantly Deducted***

The non-resident service providers may apply for a refund of the withholding tax that has been previously deducted from their payments by the resident service recipients, whereby their income should not have been taxed in Turkey as per the rules of the relevant tax treaty. Such

application shall be made to the relevant tax office by the non-resident service providers themselves or their representatives within the statute of limitation, i.e. 5 years, unless a special provision is provided in the relevant tax treaty. **Form No.3** as attached to the Communique will be submitted to the tax office to start the refund procedures.

Contact:

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