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Assessment on taxation matters to arise in case a foreign company transfers the shares of a joint-stock company resident in Turkey to another foreign company within the context of DTT between Turkey and Germany

I. Taxable income of the non-residents

As per the Article 3 of the Corporate Tax (CTL) Law no.5520, non-residents are defined as entities without legal or business center in Turkey. The Income Tax Law (ITL) no.193 adopts the principle of territoriality in limited liability since taxation is tied up to the condition of deriving the income or gain in Turkey.

Non-residents are taxed solely on the income derived in Turkey. Income and revenue obtained by non-residents are defined in Article 3 of the CTL.

Accordingly, as per the Article 26 of CTL, concerning the non-resident foreign companies, if the taxable income consists of other earnings and revenues; it is indicated that the foreign company or its representative in Turkey is required to inform the tax office with a tax return in fifteen days as of the date that they're obtained. At that stage, corporate tax deduction will be applied on the non-resident's taxable income and withholding will be applied pertaining to the Article 30/6 of the CTL.

Also, as per the 2nd clause within Article 26 of the CTL, concerning the other income and revenue, excluding the provisions on foreign exchange gain arising during the disposal of securities acquired in return for capital in cash or capital in kind transferred to Turkey and participation stocks, it's indicated that the restrictions on the exemptions, registries, terms and durations regarding untaxation in Income Tax Law shall not be considered. The repetitive Article 81 of the ITL contains the following statement: In the calculation of capital gains derived during the disposal of securities acquired in return for capital in cash or capital in kind transferred to Turkey by non-residents through getting permission from relevant authorities according to foreign capital legislation and participation stocks, foreign exchange gains are not considered. At that point, since the subsequent amendment tries to eliminate the differences between foreign capital and domestic capital, the permitting system sought for the capital inflow to Turkey as per the foreign capital legislation has transformed into a notification system. Therefore, as the requirement to get permission has been removed, it is necessary to read the requirement of permission in the form of notification when applying the repetitive Article 81.

II. Terms required to tax the income in Turkey

As specified, it is indicated in the 3/e sub-clause of the CTL's Article 3 that other income and revenues obtained in Turkey has been considered among non-residents' corporate earnings. The requirement of being obtained in Turkey is explained in the 7th clause of Article 7 within the ITL as "the payment should be made in Turkey or even if it's made in a foreign country, it should be referred to the accounts of the payer in Turkey or to the accounts of the one whom has been made payment on behalf of or retained from its profits".

As viewed from this aspect, in the circumstance that a foreign company sells the shares of a fully amenable joint-stock company in Turkey that it's holding to another Turkish resident fully amenable company, other income and revenue will be occurred in Turkey.

However, if the foreign company sells the shares of a fully amenable joint-stock company in Turkey that it's holding to another foreign company, that situation should be examined further in detail. If we prefer the literal comment concerning the matter, since the shares subject to a handover and transfer are of Turkish origin, regardless of the aforementioned shares are sold to a fully amenable company in Turkey or they are sold to a foreign company abroad, the gains acquired through the sale should be taxed in Turkey. Writing the share ledger, sales official proceedings, the whole process such as the introduction of partnership change implies recognition that the work is done in Turkey.

However it should be stated that, the predominant opinion within the literature points out that "if a foreign company sells its shares in Turkey to a Turkish resident person, the right of taxation will be on Turkey and if the sale is made to a person resident abroad then Turkey will not be entitled for taxation since the process is not handled in Turkey.

We are of the opinion that the matters such as the kind of corporation, whether a contract concerning the transfer would be signed up and submitted to the Turkish authorities or not, whether the transfer requires registration in the relevant trade registry or not should also be evaluated in terms of the practice and the provisions of the articles of association of the company to be transferred shall be examined separately in terms of the existing issues and the necessity to take decisions.

III. Assessment within the context of the DTT between Turkey and Germany

Regarding the subject of this article, the Double Taxation Treaty signed between Turkey and German on 19.09.2011 and effective as of 01.01.2011 has been examined.

Since the gains acquired by a foreign company through transferring its shares in Turkey is considered as "other income and revenue", it would be evaluated within the context of Article 13 of the DTT with Germany.

(1) Gains derived by a resident of a Contracting State from the alienation of immovable property referred to in Article 6 and situated in the other Contracting State may be taxed in that other State.

(2) Gains derived by a resident of a Contracting State from the alienation of shares and similar rights deriving more than 50 per cent of their value directly or indirectly from immovable property situated in the other Contracting State may be taxed in that other State.

(3) Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise) or of such fixed base, may be taxed in that other State.

(4) Gains derived by a resident of a Contracting State from the alienation of ships or aircraft operated in international traffic, or movable property pertaining to the operation of such ships or aircraft shall be taxable only in that State.

(5) Gains from the alienation of any property other than that referred to in paragraphs 1, 2, 3 and 4, shall be taxable only in the Contracting State of which the alienator is a resident. ***However, the capital gains mentioned in the foregoing sentence and derived from the other Contracting State, shall be taxable in the other Contracting State if the time period does not exceed one year between acquisition and alienation.***

Pertaining to the terms of the treaty, income arising from the disposal of shares shall be taxed by Germany, the contracting country where the seller is resident, as per the 5th clause of the treaty's Article 13 except the particular circumstance indicated in the 2nd clause. Under the circumstances indicated in the sentence of the related clause starting as "however" Turkey, the country of origin is authorized for taxation. The time period between the acquisition and disposal of shares should not exceed one year and there should be a capital gain derived in that country, for the country of origin to be authorized to get taxes over purchase/sale gains. The exception to this is explained in the 2nd sub-clause of Article 13. If shares or similar rights over 50% of their value, directly or indirectly, consisting of shares representing property assets are sold, the country of origin would be entitled for taxation.

As per the Protocol's (which shows unity with the treaty of Germany) Article 5 titled as "Regarding the 5th clause of Article 13", it is indicated that the concerning clause shall not apply over the income arising from the sale of shares quoted in the stock exchange of one of the contracting countries or income arising from the disposal of shares in a company's restructuring process.

The wording of restructuring in the Protocol is not defined in the Treaty and Turkish legislation does not have a definition for restructuring as well. The lack of a definition for the relevant wording leads complexity during the implementation of the provisions within the Treaty. At that stage, we are of the opinion that the concept of "restructuring" mentioned in Article 5 of the Protocol should be clarified in order not to lead to different practices.

Additionally, although it is not clearly mentioned in the Article 13 of the DTT between Turkey and Germany regarding the capital gains, taxpayers wishing to benefit from the terms of the Treaty should get a certificate of residence from the authorities of the country they are resident indicating that they are the taxpayers of that country.