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# The practice of controlled foreign corporation rules

With globalization, many companies make their investments to no-tax or low tax rates jurisdictions in order to benefit from tax reliefs or reduced tax rates; and therefore, their practices have caused harmful tax competition and tax evasion. To eliminate the negative effects of the said jurisdictions with no-tax and low-tax rates on governments and prevent the harmful tax competition, countries take various tax security measures. Accordingly, one of the tax security measures implemented by countries is, undoubtedly, the Controlled Foreign Corporation ("CFC").

We see that the first practices in the field of CFC started in the USA in 1962, followed by England, Germany and Japan. Although the practices of CFC between countries differ from each other, they all serve the same purpose. In general, a CFC is a foreign corporation that is directly or indirectly controlled by a resident taxpayer. There are some criteria applied by the countries to determine the CFC. Some approaches refer to shareholder value or voting rights held by resident taxpayers, while others state that a foreign corporation is a CFC if it operates in a low-tax country. Further, the countries define CFC income differently; for instance, some countries apply CFC rules to all types of income, where others only apply them to passive income.

Turkish CFC rules have come into effect in Article 7 of Corporate Tax Code No. 5520. CFC regulations applies when Turkish tax-resident companies and real persons, either collectively or individually, and either directly or indirectly hold at least %50 of shares of a foreign company, in which the foreign company would carry the below listed conditions all at once:

1. More than 25% of the foreign company’s income apart from the commercial, agricultural and independent professional services that are performed in conformity with the equity, organization and labour force, would constitute of passive nature income such as interest, dividend, rental income, royalty, capital gains,
2. Foreign company should be effectively taxed under 10%,
3. Total turnover of the company in a related year would exceed TRY 100,000.

If the foreign company would be classified as CFC, Turkish corporate taxpayer that holds shares in the foreign company would need to declare the profit that is attributable to its shareholding ratio in the foreign company as CFC income; it is considered as distributed even if the foreign company does not distribute its dividends. Accordingly, such CFC income would be subject to corporation tax (“CT”) in Turkey. In case, foreign company distribute dividends to shareholders, the previously taxed portion is not subject to CT again.

On December 20, 2021, the Organisation for Economic Cooperation and Development ("OECD") released the model Anti Global Base Erosion Rules ("GloBE") approved within the scope of OECD/G20 BEPS, which are part of a two-pillar solution that provides a global minimum corporate tax of 15%. As a result of these developments, currently it is not expected that any changes will be made to regarding the CFC rules.

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Considering the features of the CFC rules in Turkish legislation, it is one of the comprehensive CFC regimes compared to other countries' practices.

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