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The Turkish Digital Service Tax is around the Corner

Mahmut Aydemir (EY) · Monday, November 11th, 2019

The digital economy is faced with major challenges for the international tax system since the traditional tax rules seem to be insufficiently well designed to govern new ways of conducting businesses and unsuitable for accurately detecting and allocating the value created from digitalised business models.[1] This situation has triggered a political and academic discussion about how international taxation can be reformed to provide a "reasonable and stable system for taxing profits of multi-national companies in the 21st century".

In the course of the Base Erosion and Profit Shifting project, the Organisation for Economic Co-operation and Development (the "**OECD**") has labelled the tax challenges of the digital economy as Action 1, and it concluded that digital business models create substantial opportunities for aggressive tax planning but also raise several issues for the international tax system.[2] As a consequence, on 31 May 2019, following the amendments to its 2017 Model Tax Convention, the OECD released a report involving different proposals to be a consensus solution to the tax challenges of digitalization.[3] The OECD grouped these proposal into two pillars which could form the basis for consensus. Pillar 1 consisting of three different options focuses on the allocation of taxing right and seeks to undertake a coherent and concurrent review of the profit allocation and nexus rules. However, Pillar 2 focuses on the remaining BEPS issues and seeks to develop rules which would provide jurisdictions with a right to tax back in case other jurisdictions have not exercised their primary taxing right or the payment is otherwise subject to low levels of effective taxation. As part of the ongoing work of the OECD/G20 Inclusive Framework on BEPS, on 9 October 2019, the OECD released its Secretariat Proposal for a "Unified Approach" which is intended to include four elements: a) scope, b) economic nexus, c) formulary apportionment profit allocation, and d) binding dispute resolution under the Pillar 1 Public Consultation Document.[4] In addition to this, on 8 November 2019, the OECD secretariat is seeking public comments on certain aspect of the Global-Anti-Base Erosion Proposal under Pillar 2.[5]

Similarly, on 21 March 2018, the EU Commission published a comprehensive legislative proposal laying down a new set of tax rules applicable to the digital economy, including a new concept of a permanent establishment (the "**PE**") that can be established whereby the taxable nexus is a "significant digital presence".

Additionally, the lack of a consensus on the international level has compelled countries to take different measures unilaterally to handle the tax challenges of the digital economy. For example, Israel and India are the pioneers among other countries that have already taken actions through the creation of a new nexus as a Digital PE to tax the income of non-resident enterprises. In addition to the Digital PE, the Digital Service Tax (the "**DST**") as an interim action to the tax challenges of the digital economy is implemented by some countries, such as France and the UK. The aim of these measures is deemed to cover the profit deriving from the digital business models to ensure the corporate tax system is sustainable and fair across different types of businesses.

Turkey is another country which is willing to take unilateral actions to tax the income of digital companies. In this regard, Turkey initially introduced a digital tax on the cross-border online advertising services by Presidential Decree No. 476 (the "**Presidential Decree**") published on 19 December 2018. The Presidential Decree brought a withholding tax liability for payments made for cross-border online advertising services regardless of whether the payee is a taxpayer in Turkey. Following the Presidential Decree, on 24 October 2019, the Turkish Government submitted an initial bill which introduces a DST into Turkish tax legislation. The aim of this bill is to ensure that digital businesses pay a tax that reflects the value that they derive from the Turkish market. The bill was sent by the Government to the Turkish Parliament for ratification. Even though the initial bill is not the final version of the upcoming legislation, a comparison between the UK's and the French DST might shed some light on its possible application.

Most importantly, the initial bill authorizes the Ministry of Treasury and Finance (the "**Ministry**") to warn companies and their representatives if they are not registered for Digital Services Tax. The bill also enables the Ministry to request banning the electronic activities of the respected companies from the Information Technologies and Communication Authority provided that no action has been taken by such companies.

Who is likely to be affected by the Turkish DST?

Large multi-national enterprises with revenue generated from the provision of digital advertising services, the sale of any audio, visual or digital content in a digital platform to listen, to watch, to play and to record in the digital area will fall within the scope of this legislation. In addition to this, the revenue arising from a digital media platform that makes a digital interface available allowing users to contact and interact with each other for the purposes of delivering goods or services is also included in its framework. The initial bill also covers the revenue of intermediary services provided in the digital environment for the services mentioned above. The initial bill states that liability for the DST is not relevant to the residency of the taxpayer. Therefore, whether the taxpayer is a resident or non-resident taxpayer, or carries out business activities in Turkey through a PE or representative is irrelevant for the liabilities of the DST.

What is the revenue threshold?

The initial bill is designed to cover only highly digitalised companies whose revenues go beyond a certain level. Therefore, only certain businesses providing services that are included in the scope of the DST will be subject to it if their overall global and the domestic revenue (i.e. revenue generated in Turkey) exceeds two thresholds during the previous financial year. These thresholds are as follows;

- EUR 750 million consolidated group revenues, and;
- TRY 20 million (approximately EUR 3.1 million) in Turkey.

There is an allowance of TRY 20 million, which means a group's first TRY 20 million of revenue generated from the services provided in Turkey will not be subject to the DST.

When comparing these thresholds with the UK's (GBR 500 million worldwide and GBR 25 million in the UK) and the French DST (EUR 750 million worldwide and EUR 25 million in France), the threshold related to the domestic revenue seems to be quite low. Therefore, considering the Turkish population (more than 80 million), the number of Internet users in Turkey and the threshold for domestic revenue, more enterprises are expected to be subjected to the Turkish DST than its counterparties.

What is the rate of the DST?

Pursuant to this bill, the 7.5% tax will be levied on the sale generated in Turkey. In other words, the tax rate of digital services is proposed at 7.5% of gross revenue related to Turkey sales. The President has the authority to reduce the rate to 1% or double the rate of 7.5%, based on the service type, separately or all together. As compared with other countries (e.g. 3% in France and 2 % in the UK), the proposed tax rate seems to be quite high.

The tax period of the DST which is proposed to be on a monthly basis is another issue which needs to be considered. Taxpayers and those responsible for withholding the DST declare and remit such taxes to the Turkish tax authorities until the last day of the following month.

Are there any exemptions?

The below-mentioned services are envisaged to be exempted from the DST:

- Services that are subjected to "treasury duty" are paid in accordance with the Telegram and Telephone Law *published in the Official Gazette of 12 December 1924, No. 59*) (Law No.: 406),
- Services that are subjected to special communication tax,
- Services within the scope of Article 4 of the Turkish Banking Law (*published in the Official Gazette of 1 November 2011, No. 25983*) (Law No.: 5411), and
- Payment services within the scope of Article 12 of the Law on Payment and Securities Settlement System, Payment Services and Electronic Money Institutions (*published in the Official Gazette of 27 July 2013, No. 28690* (Law No.: 6493).[6]

What is the main criterion of the DST?

Contrary to the UK's DST which will apply to the revenues that are attributable to in-scope business models whenever they are linked to UK users[7], the initial bill of the Turkish DST targets the revenue of the above-mentioned services "provided only in Turkey". This means that the main criterion for this bill is not the user, as set out in the French legislation, but it focuses on the taxable services provided in Turkey.

As per this bill, service is deemed to be provided in Turkey in the case when;

1. The service is to be provided in Turkey,
2. It is benefited from the service in Turkey,
3. The service is to be performed for those located in Turkey,
4. The service is to be assessed in Turkey, or
5. Processing or transferring data obtained from the digital environment from users located in Turkey or from their activities.

Evaluations on the Proposed DST

To sum up, the framework of this bill is quite similar to the UK's and the French DST.[8] For this reason, it is foreseen that its application will be more likely similar to its mentioned counterparties. However, it is not known whether it is going to be "interim" legislation since Turkey is part of the OECD and G20 which are dedicated to offering a definitive solution in 2020. In the case where there is no such solution under the OECD Pillar 1, a number of countries are expected to enact similar DSTs into their legal system. Additionally, the DST may not be able to bring a comprehensive and sustainable solution, rather, it will ring-fence the digital economy, and it will create more and more disputes. For instance, specific to the Turkish DST, it is not clear whether these two taxes (15% withholding tax on the cross-border advertising services which has been introduced by a Presidential Decree in 2018 and 7.5% DST) are simultaneously applicable for cross-border online advertising services. If so, there would be a double taxation issue on the same income for non-resident multinationals which do not have a presence in Turkey.

Apart from this, the nature of the DST is also questionable. Even though the DST is proposed as part of "Expenditure Taxes Law" under the Turkish tax legislation, the tax base for the DST is revenue derived from the provision of the respective services during the related tax period, and it may be regarded as a VAT-assimilated tax or even another income tax. Furthermore, the fact that the tax basis is quite challenging to assess, in terms of revenue carve-out and territoriality, the DST might be considered being unlawful as tax laws are required under the constitution to be understandable (under the "intelligibility" principle). Also, the DST will be out of the scope of all tax treaties, so the tax territoriality principles under the treaties do not apply to the DST, and the DST cannot benefit from any tax credits. That is why taxation of the digital economy should be discussed more at the international level, and the actions should be taken through a multilateral agreement by a high level of participants to make them feasible and sustainable.

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END NOTES

[1] Olbert M, Spengel C. *International Taxation in the Digital Economy: Challenge Accepted?* 2017, (World Tax Journal, 2017 (Volume9),No.1),IBFD,<https://0-research-ibfd org.catalogue.libraries.london.ac.uk/#/docurl=/collections/wtj/html/wtj_2017_01_int_4.html (accessed 11 July 2019)

[2] OECD (2018), Tax Challenges Arising from Digitalisation – Interim Report 2018: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://doi.org/10.1787/9789264293083-e.

[3] OECD/ G20 (2019), Inclusive Framework on BEPS, Programme of Work to Develop a Consensus Solution to the Arising from the Digitalisation of the Economy – Pilar I, OECD/G20 Base Erosion and Profit Shifting Project, OECD, Paris, http://www.oecd.org/tax/beps/programme-of-work-to-develop-a-consensus-solution-to-the-tax-challenges-arising-from-the-digitalisation-of-the-economy.pdf (accessed 19 July 2019)

[4] Secretariat Proposal for a "Unified Approach" under Pillar One, Public Consultation Document, OECD (Oct. 9, 2019) (hereafter "Unified Approach"). Available

at https://www.oecd.org/tax/beps/public-consultation-document-secretariat-proposal-unified-approach-pillar-one.pdf (accessed 9 October 2019)

[5] For the scope of this article, the OECD proposals under Pillar 1 and Pillar 2 are not worked through.

[6] https://mnetax.com/turkey-proposes-7-5-percent-digital-services-tax-on-large-multinationals-36377

[7] https://www.gov.uk/government/publications/introduction-of-the-new-digital-services-tax/introduction-of-the-new-digital-services-tax

[8] Although the scope of the bill more or less resembles a combination of the French and the UK DST, there are some minor differences between them. For example, the sale of data for advertising services is not subject to the upcoming Turkish DST, while the French DST covers the sale of data as well.

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