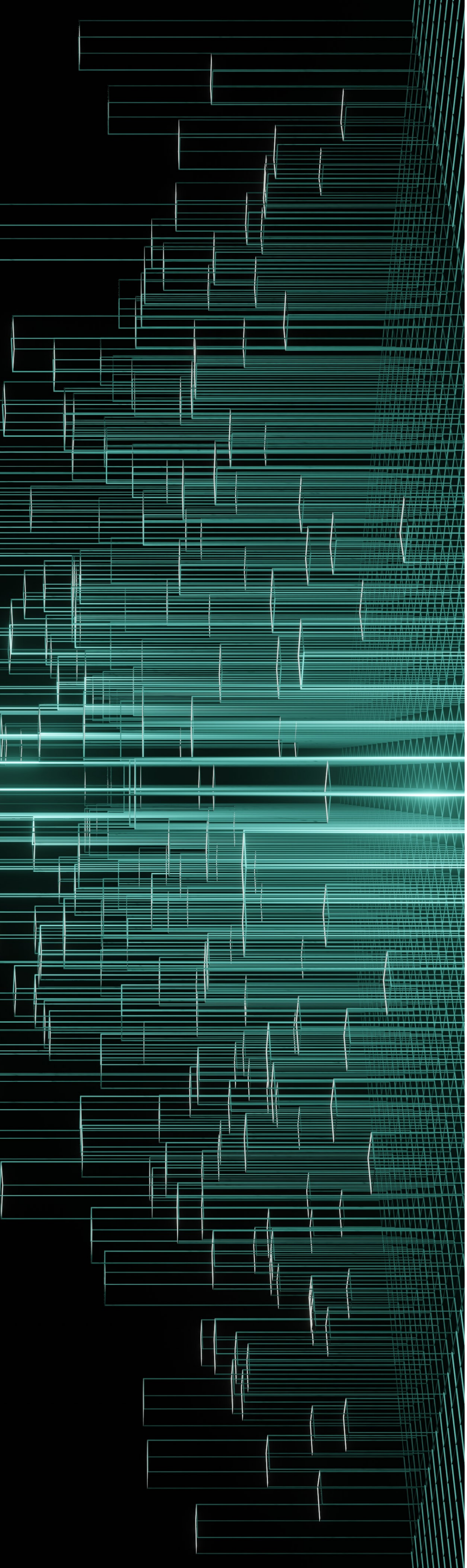

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Two Pillar Approach to Tax Problems Arising from the Digitization of the Economy

With the increasing digitalization in the economy, Organization for Economic Cooperation and Development (“OECD”) and G20 had commenced working on the Inclusive Framework on Base Erosion and Profit Shifting (“BEPS”) on the grounds that the current international tax rules are not sufficient for the taxation of multinational enterprises (“MNEs”) and are not suitable for changed business models.

As a result of lengthy negotiations to revise international tax rules and adapt them to the digital economy, under the leadership of OECD and G20, international taxation rules including the Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalization of the Economy adopted by consensus of the 140 members of the Inclusive Framework on BEPS in October 2021.

The aforementioned new system consists of Pillar 1 and Pillar 2. This two-pillar solution ensures that MNEs are subject to a minimum corporate tax of 15% and that the largest-profitable multinational enterprises reallocate their profits to countries around the world.

The rules set in the context of Pillar 1 and Pillar 2, will lead to significant changes in current international taxation standards. In particular, one of these changes is the repeal of the Digital Services Tax and similar unilateral practices implemented by many countries as a temporary solution until a common solution is found under the OECD.

Pillar 1: Revenue Based Distribution Key

Pillar 1 establishes a new international taxation ground for a more equitable distribution of profits and taxation rights of MNEs with global revenues exceeding EUR 20 billion and profitability exceeding 10%. In the context of Pillar 1, 25% of the residual profits of companies whose profitability exceeds 10% are distributed among the market countries in accordance with the revenue-based distribution key, and these profits are taxed in the relevant countries.

The profits of the companies that meet certain conditions are reallocated to the countries where the sales take place, regardless of their physical presence in these jurisdictions. Pillar 1 is estimated to result in a reallocation of profits of USD 125 billion globally.

Within the scope of Pillar 1, it was aimed to open the Multilateral Convention for signature in 2022 and enter into force in 2023. However, according to the OECD’s July 2022 Report, it was stated that there will be a one-year delay in the implementation schedule of Pillar 1. At the present stage, the new Multilateral Convention to implement Pillar One will be finalized by mid-2023 for entry into force in 2024 under a revised timeline.

Pillar 2: Global Minimum Corporate Tax

Pillar 2 introduces that in case the revenue of MNEs with an annual income exceeding 750 million Euros in another country is taxed less than 15%, a global minimum corporate tax is applied on the income arising in each jurisdiction where they operate. Within this scope, the country of the ultimate parent business of MNE will have the taxation right where the effective tax burden of the market country is below 15%.

On December 20, 2021, OECD published the "Global Anti-Base Erosion Model Rules (Pillar Two)" on the second step of the two-step approach approved under the OECD/G20 BEPS. The aforementioned Model Rules include the Income Inclusion Rule (IIR) and the Undertaxed Payment Rule (UTPR); all these rules are collectively referred to as the Global Anti-Base Erosion Model Rules ("GloBE Rules").

The global minimum corporate income tax of 15% within the scope of GloBE rules is applied to MNEs that have annual revenue of EUR 750 million or more in the Consolidated Financial Statements of the Ultimate Parent Entity in at least two of the four Fiscal Years immediately preceding the tested Fiscal Year.

With the Income Inclusion Rule, a liability to top-up tax for a member of an in-scope MNE group is envisaged. Under the IIR, if the effective tax rate for the entities in a particular jurisdiction is below the 15% minimum, then the group must pay a top-up tax to bring its rate up to 15%. In this context, IIR as the main mechanism to ensure the taxation of "untaxed" profits, operates similarly to the Controlled Foreign Entity rules. It is expected that IIR will be implemented by 2023.

The Undertaxed Payment Rule is applied as a secondary rule where the effective tax rate in a country is below a minimum of 15% but the IIR is not fully implemented. It is expected that the UTPR will be implemented by 2024.

Within this new approach, considering that the market countries are predominantly developing countries, tax revenues are expected to increase in these countries since developing countries will have the right to tax these revenues.

At the stage reached regarding Pillar 2, all European Union member states have reached an agreement to implement the global minimum corporate tax. The directive has to be transposed into member states' national law by the end of 2023.

Digital Service Tax

The inability to produce a globally accepted solution for the taxation of the digital economy has led many countries, including the UK, France, Austria, Italy, Spain, and India, to implement the digital service tax regarding taxing various services offered in the digital environment. In this context, the ”digital service tax” in Turkey, which aims to tax the services offered in the digital environment, came into effect on March 1, 2020.

Subsequently, in the statement made by the United States of America (“USA”) Trade Representative Office on June 2, 2020, it was stated that a competition investigation will be launched against some countries that apply digital services tax, including Turkey.

On October 21, 2021, the USA, Austria, France, Italy, Spain, and the United Kingdom reached a consensus to adopt the existing Unilateral Measures (“Unilateral Measures Consensus”) regarding the implementation of Pillar I. The Unilateral Measures Consensus was signed by the six mentioned countries and a joint statement (the “21 October Joint Statement”) was published.

Accordingly, it was stated that the digital service taxes accrued in the period between January 1, 2022 and December 31, 2023 (in case the application enters into force earlier) -during the transition period- can be deducted from the corporate taxes calculated within the scope of Pillar I in the following years. It has been regulated that digital service tax payments above the said amount can be deducted from the corporate taxes to be paid in the following years by the companies included in the scope. In return, the USA reached an agreement to remove the additional customs duties that it had applied and suspended as a result of the trade investigation it initiated against the said countries, including the investigations which took place before 8 October.

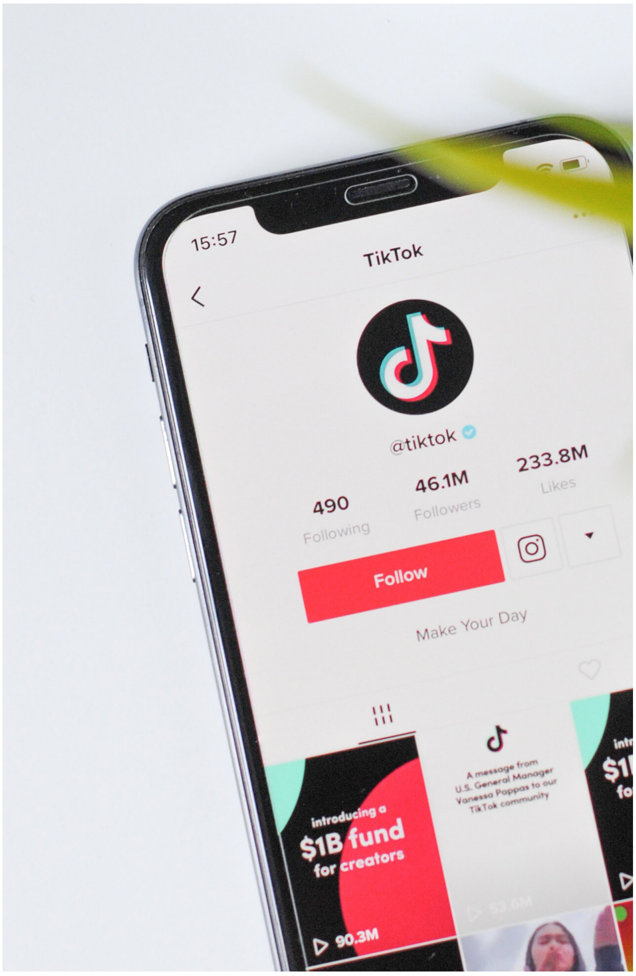
In the announcement dated November 22, 2021, published by the Ministry of Treasury and Finance, it was stated that Turkey and the United States agreed that the conditions applicable under the Unilateral Measures Consensus regarding the digital service tax will also be valid between Turkey and the USA. As a result, Turkey was included in the USA compromise with 5 countries implementing Digital Services Tax.

Withholding Tax in Digital Advertising Services

The withholding tax applied to the advertising services provided on the internet is another regulation that has been introduced in Turkey to tax digital companies.

With the Presidential Decree No. 476 published in the Official Gazette dated 19.12.2018 and numbered 30630, the online advertising services provided on the internet were included in the scope of tax withholding, and it is stipulated that payments made to the providers of such services or those who act as an intermediary for the provision of such services will be subject to tax withholding regardless of the recipients of the payments are taxpayers or not.

Accordingly, regarding the online advertising services provided on the internet, it has been regulated that the below withholding tax rates are applied to the aforementioned payments depending on the status of the service provider, as of 01.01.2019.



- 15% over the payments made within the scope of Article 94 of the Income Tax Law No. 193 (payments made to real persons, associations and foundations, and other persons or enterprises within the scope of Article 94),
- 0% over the payments made within the scope of Article 15 of the Corporate Income Tax Law No. 5520 ("CITL") (payments made to taxpayers subject to full tax liability),
- 15% over the payments made within the scope of Article 30 of CITL (payments to taxpayers subject to limited tax liability).

Nevertheless, on the grounds that the said withholding tax is taxation on the commercial income of taxpayers subject to limited tax liability, and therefore, the aforementioned taxation constitutes a violation of the Prevention of Double Taxation Agreements concluded between the Republic of Türkiye and the other related countries; lawsuits are filed by the taxpayers who pay these taxes as a tax responsible in order to cancel and refund the taxes paid.

Taxation of Crypto Assets

Crypto assets appear as one of the applications of distributed ledger technologies that allow records to be kept in a distributed and decentralized manner. Considering the different application aims of crypto assets, it is seen that their legal characteristic is determined differently in different legal systems.

The Regulation on the Non-Use of Crypto Assets in Payments ("Regulation"), which is the only regulation in Turkey regarding crypto assets, published by the Central Bank of the Republic of Turkey entered into force on 30.04.2021.

In this context, pursuant to Article 3 of Regulation, crypto assets are defined as **intangible assets** which are virtually created with the use of distributed ledger technology or similar technology and distributed over digital networks but cannot be considered as money, electronic money, payment instruments, securities or capital market instruments. In that regard, Regulation is not a general regulation on crypto assets, but a limited legislation only for the purpose of "determining the methods and tools to be used for payments". Also, it is seen that the same definition is made in the Guide on "Basic Principles Regarding the Obligations for the Prevention of Laundering Proceeds of Crime and Financing of Terrorism for Crypto Asset Service Providers" published by the Financial Crimes Investigation Board. However, there is no definition made within the scope of tax legislation as of November 2022, and the definition within the scope of Article 3 of the Regulation is not a definition in terms of tax.

In addition, another definition of crypto assets is made by the Istanbul 24th Enforcement Law Court within the decision dated 19.4.2021 and numbered E.2021/586, K.2021/675. In the decision, the crypto assets are considered within the scope of commodities or securities, and they are accepted as a kind of digital currency or virtual currency, therefore they could be sequestrated.

At the current stage, there is no special regulation in Türkiye regarding the tax legislation on how to tax earnings from crypto assets. Therefore, these gains can only be examined within the scope of general tax legislation. Expectations for the definition of crypto-assets are generally whether cryptocurrencies will be defined as “money”, “securities” or “commodities”. It is thought that the definition to be made will form the basis of the taxation of cryptocurrencies. Pursuant to the principle of legality of taxation, it is not a legally correct approach to subject cryptocurrencies to a tax type as a result of the expansionary interpretation, unless the legal nature of cryptocurrencies is clearly determined. Within the scope of this principle, crypto assets should be defined as separate economic assets in the tax legislation and tax provisions should be regulated by considering the unique characteristics of crypto assets.

In this context, within the scope of the current tax legislation, the subject can be evaluated as follows:

The fact that the cryptocurrency activity is (i) based on capital and labor, (ii) continuous, and (iii) carried out within an organization as a commercial activity causes the earnings to be qualified as commercial income. In this context, earnings gained within the scope of commercial activities related to the buying and selling of cryptocurrencies by real persons are also commercial earnings.

The earnings gained as a result of activities related to cryptocurrencies by the capital companies listed in Article 1 of Corporate Tax Law No. 5520 are subject to corporate income tax. In this context, the commission income gained by the companies that act as an intermediary in the buying and selling of cryptocurrencies may be considered corporate income and subject to corporate income tax.

Various evaluations can be made regarding the nature of cryptocurrencies in order to tax the profits, which are earned as casual by natural persons and do not meet the conditions of commercial gain. These evaluations are summarized as follows:

Evaluation as intangible asset

Cryptocurrencies can be considered as intangible rights pursuant to both Article 3 of Regulation and Article 70/2-5 of Income Tax Code No. 193 (“ITC”) which regulates real property income including *“the right to use or the privilege of use over a secret formula or a manufacturing method with knowledge of an experience gained in the fields of industry, trade, and science”*. However, crypto assets have almost no resemblance to the rights listed above. Therefore, although the definition of intangible assets is given for the crypto assets in the Regulation, this statement cannot constitute a justification for classifying crypto assets within the rights set forth in Article 70/2-5 of ITC.

If cryptocurrencies are included in the scope of intangible assets in the tax legislation, the gains arising from the disposal of crypto assets are taxed as a capital gain in accordance with article 80/1-2 of ITL.

Evaluation as security

Pursuant to Article 3 of Capital Markets Code No. 6362 (“CMC”) securities are listed including “*Except money, cheques, bills and bonds; 1) Shares, other securities similar to shares and depository receipts for the said shares, 2) Debt instruments or securitized assets and income, and depository receipts for the said securities”*. Crypto assets are not included in this article. In case cryptocurrencies are included in the scope of securities, pursuant to bis Article 67 of ITC, cryptocurrencies are subject to income tax as capital gains.

Evaluation as commodity

Assuming that the cryptocurrency trading activity is carried out only once as a non-continuous activity and profit is gained as a result of this single transaction, in terms of crypto assets that are considered commodities, these would be taxed as casual income pursuant to Article 82 of ITC.

Evaluation as money

There is a consensus in Turkish law that cryptocurrencies cannot be described as money since they must be accepted as a means of payment by the legal order in order to be able to accept as money in the legal sense. As a matter of fact, Article 3 of the Regulation and in the press release of the Banking Regulation and Supervision Agency No. 2013/32, it is clearly stated that cryptocurrencies are not considered as foreign currency, electronic money, or money. However, if cryptocurrencies are accepted as money/currency, there will be no income tax burden on natural persons, since ”money” is not listed in the ITC as an income element.

In addition, in the Revenue Administration’s ruling dated 23.09.2020 and numbered 60938891-120.01.02.09[ICT: 3-1]-33826, the administration’s opinion was presented on whether there is an Inheritance and Transfer Tax in the transfer of the Bitcoin asset in the account of the deceased to the heirs. In the aforementioned ruling, it is defined that the goods subject to Inheritance and Transfer Tax, express all the rights and receivables of movable and real estate that may be the subject of ownership. And it is stated that the total value of the Bitcoin asset transferred to the heirs should be declared by the heirs with the Inheritance and Transfer Tax declaration. Another opinion of the Revenue Administration on cryptocurrencies has not been published yet.

As a result, it is thought that instead of including crypto assets in traditional structures, an independent taxation regime should be introduced according to their unique characteristics.

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