PRIMETAX GUIDE: CONTROLLED FOREIGN CORPORATION (CFC) REGIME IN TÜRKIYE

INTRODUCTION

The "Earnings of Controlled Foreign Corporations" concept was introduced into the Turkish tax system under Article 7 of the Corporate Tax Law No. 5520. This regulation aims to impose taxes on income generated by taxpayers who invest in low-tax jurisdictions through foreign subsidiaries, even before such earnings are repatriated to Türkiye.

According to Article 7, the following conditions must be met for taxation in Türkiye:

- Resident taxpayers must hold at least a 50% direct or indirect ownership interest—separately or collectively—in a foreign company's capital, profit share, or voting rights.
- At least 25% of the foreign company's total gross revenue must consist of passive income, such as interest, dividends, rent, license fees, and capital gains, rather than income from commercial, agricultural, or independent professional activities involving capital, organisation, and employment.
- The foreign company must be subject to an overall tax burden of less than 10% on its balance sheet profit, including income and corporate tax.
- The foreign company's annual gross revenue must exceed the equivalent of TRY 100,000 in foreign currency.

Minimum 50% Participation Rate

As explicitly stated in the law, the foreign entity is deemed controlled if a resident corporation holds at least 50% ownership of a foreign company. This control factor is determined based on both direct and indirect ownership and collective participation by multiple resident taxpayers.

Passive Income Threshold

A foreign company's earnings will be taxed in Türkiye if at least 25% of its gross revenue:

- Does not originate from commercial, agricultural, or professional activities requiring capital, organisation, and employment or
- Consists of passive income, such as interest, dividends, rent, license fees, or capital gains.

Tax Burden Threshold (Less than 10%)

The tax burden of the foreign company is calculated using the following formula:

TTB (Total Tax Burden) = AT (Accrued Tax) / (DCI (Distributable Corporate Income) + AT)

Distributable corporate income refers to the foreign company’s trade balance profit after deducting accrued taxes.

Annual Gross Revenue Threshold (TRY 100,000)

To determine whether a foreign company's earnings meet this threshold, the earnings must be converted into Turkish lira based on the Central Bank of Türkiye's exchange rate on the last day of the company's fiscal year.

PrimetaX

Taxation Period in Türkiye

According to Article 7 of the Corporate Tax Code, if all the above conditions are met, the profits earned by the foreign company are included in the resident corporation's corporate tax base, proportional to its ownership share, as of the fiscal period in which the foreign company's fiscal year ends.

Variability in Participation Rate Throughout the Year

If a resident corporation's ownership percentage fluctuates during the year, the highest ownership rate at any fiscal period will determine whether the control condition is met. However, the taxable portion of the foreign company's profits will be included in the resident taxpayer's corporate tax base based on the ownership percentage at the end of the fiscal period.

Disposal of Shares Before Taxation Period Ends

Suppose shares in the foreign company are sold before the end of the taxation period without engaging in artificial transactions. In that case, taxation under this regime does not apply—even if ownership exceeds 50% at some point during the year. Artificial transactions refer to activities designed to avoid taxation, such as temporarily selling shares before the tax period ends and repurchasing them afterwards.

Foreign Taxes Paid

To prevent double taxation, foreign taxes paid on the earnings of the foreign company can be credited against the corporate tax liability in Türkiye, per Article 33 of the Corporate Tax Code.

Subsequent Profit Distribution by Foreign Companies

According to Article 7, if income previously taxed under the CFC regime is later distributed by the foreign company as dividends, the portion of the distributed profit already taxed in Türkiye will not be subject to corporate tax again. This provision prevents double taxation on the same income when it is eventually repatriated.

This framework ensures income earned through controlled foreign corporations is taxed reasonably while preventing tax avoidance through low-tax jurisdictions.

***