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Third Sector Foundation of Türkiye

02

Taxation

of the Economic
Enterprises of
Associations and
Foundations



Prof. Leyla Ateş & Assoc. Prof. Özgün Akduran

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About us

Founded in 1993, the Third Sector Foundation of Türkiye (TÜSEV) aims to develop solutions to the common and current problems faced by civil society organizations (CSOs) in Türkiye. With over 30 years of experience and support primarily from our Board of Trustees, we continue our activities with the goals of:

- Creating an enabling and supportive legal and fiscal environment for CSOs,
- Promoting strategic and effective giving,
- Ensuring dialogue and cooperation between the public sector, private sector, and civil society,
- Promoting Turkish civil society internationally and establishing cooperation,
- Enhancing the reputation of civil society,
- Conducting research on civil society and increasing knowledge,

We continue our activities for a stronger, more participatory and reputable civil society in Türkiye.

Abbreviations

Ba/Bs Form	Declaration Form Regarding Purchases of Goods and Services/Declaration Form Regarding Sales of Goods and Services
VAT	Value Added Tax
VATL	Value Added Tax Law
CITL	Corporate Income Tax Law
GNAT	Grand National Assembly of Türkiye
OECD	Organization of Economic Cooperation and Development
SGK	Social Security Institution
CSO	Civil Society Organizations
STGM	Association of Civil Society Development Center
TÜSEV	Third Sector Foundation of Türkiye

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Preface

As the Third Sector Foundation of Türkiye (TÜSEV), we have been working to improve the legal, financial and operational infrastructure of civil society since 1993. We aim to create solutions to the problems faced by civil society organizations (CSOs) and contribute to their operation in a more enabling environment, through the activities we carry out for the presence of a stronger, more participatory and reputable civil society in Türkiye. The activities which we started to carry out in October 2021 together with the Association of Civil Society Development Center (STGM) under TÜSEV's Civil Society Law Reform Program and which we conduct within the scope of the Monitoring Freedom of Association Project funded by the European Union Delegation to Türkiye, are aimed at raising awareness on the legal and financial legislation concerning CSOs, monitoring and improving the enabling environment for civil society, and strengthening the public-CSO cooperation.

The activities and research we conduct as TÜSEV indicate the importance of access to financial resources and financial sustainability for civil society to continue working effectively and for development of civic space. The main steps of the reforms to strengthen CSOs' capacities of securing resources include diversification of financial resources, elimination of obstacles to access to resources, and introduction of a structure that is more incentivizing for CSOs and donors in the financial and tax regulations concerning civil society.

We are glad to present our series of three publications, which we hope will guide both civil society organizations and the public sector by examining the tax regulations concerning CSOs in Türkiye under three main themes and suggesting steps for improvement. Our first publication, ***Tax Regulations Concerning Associations and Foundations***, aims to identify regulations and tax advantages that will support CSOs, by examining the impact created by the current tax regime on CSOs' financial sustainability. ***Taxation of Economic Enterprises of Associations and Foundations*** focuses on revealing the problems faced by CSOs' economic enterprises due to fiscal/tax regulations and suggesting recommendations to overcome these problems. The final publication in the series, which is titled ***Public Benefit and Tax Exemption Statutes***, examines the statuses of public benefit associations and tax-exempt foundations, and outlines steps that can be taken to ensure equal access of more CSOs to these statuses, to reduce tax liabilities on public benefit activities, and to encourage giving. These publications provide a comparative analysis of the situation in Türkiye in comparison with examples from other countries and include the results of the research on the Fiscal/Tax Framework concerning Civil Society in Türkiye partaken by more than 150 CSOs and experts.

As TÜSEV, we will continue to share our knowledge and experience with our stakeholders through the areas of interaction and communication we create and the information resources we produce, and we will continue our efforts for a stronger, more participatory and reputable civil society. We would like to extend our gratitude to Prof. Leyla Ateş and Assoc. Prof. Özgün Akduran, who authored the publications, as well as all the individuals, institutions and organizations who were involved in the preparation of the series and contributed their opinions.

Sincerely,

TÜSEV

Getting started

Enhancing civil society organizations' financial capacities is a public policy objective in Türkiye. This objective has often been stated in development plans, which constitute fundamental policy documents. The most recent Twelfth Development Plan (2024-2028) reiterates this objective and explicitly lists financial regulations to be introduced in the fiscal area in order to contribute to the financial sustainability of civil society organizations, among the measures to be taken for this purpose.¹ Carried out within the scope of the Monitoring Freedom of Association Project, which was implemented through the cooperation between the Third Sector Foundation of Türkiye (TÜSEV) and the Association of Civil Society Development Center (STGM) and funded by the European Union Delegation to Türkiye, our study aims to formulate legal design proposals regarding the financial reform regulations in question, by means of the research findings obtained through qualitative and quantitative research methods as well as comparative law methodology.

The financial system of civil society organizations, or "associations and foundations" as referred to in the tax legislation, should be addressed from three aspects. The first is the tax regulations concerning associations and foundations. Associations and foundations may be subject to various tax burdens due to the incomes they derive, expenditures they incur and assets they own, while they may also be exempted partially or wholly from some of these burdens through tax concessions. Furthermore, there are tax incentives granted by the state to income and corporate income taxpayers to support donations and aids to associations and foundations. The second aspect is regarding the treatment of economic enterprises of associations and foundations as separate corporate income tax subjects and their taxation accordingly. Thirdly, Turkish tax legislation distinguishes associations working for public benefit and foundations granted tax exemption by the President (*hereinafter referred to as "associations and foundations with status"*) from other associations and foundations in various aspects and offers a more advantageous tax regime to the holders of these statuses. The acquisition of these statuses constitutes a separate legislative system. Our study addresses these three issues in separate publications.

The timing of the study is of particular importance, since income and corporate income tax laws contain temporary articles based on which associations and foundations are taxed. The Temporary Article 67 of the Income Tax Law, whose effective period has been extended for nearly 20 years to date through legislative amendments, will expire on December 31, 2025. The Temporary Article 2 of the Corporate Income Tax Law regarding economic enterprises of associations and foundations will also expire on the same date. It is expected that these effective periods will be re-extended or the

1 Twelfth Development Plan (2024-2028), para. 938, 938.6,
https://www.sbb.gov.tr/wp-content/uploads/2024/06/Twelfth-Development-Plan_2024-2028.pdf

temporary provisions will be introduced permanently.² Temporary articles are exceptional regulations that suspend the main rule in its entirety or in certain aspects.³ As the name suggests, they do not aim for continuity; therefore, they are not designed to create a sustainable regime. However, achieving the Twelfth Development Plan's goal of contributing to the financial sustainability of civil society organizations requires the establishment of a regime focused on civil society. For this reason, a permanent fiscal regime that takes the needs of associations and foundations into account should be developed. Our three publications aim to contribute to the design of such a regime.

The economics literature does not yet provide a clear answer regarding the tax regulations which would contribute most to the financial sustainability of civil society organizations. Little is known about whether donations and aids should be incentivized; whether associations and foundations should be exempt from taxes on income, wealth and expenditures, such as income tax, value added tax, stamp duty, fees, property tax, inheritance and transfer tax, or which of these they should be exempt from, and whether economic enterprises of associations and foundations should be subject to corporate income tax, or to what extent.⁴

On the other hand, considering these questions outside of an economics framework, we should note that volunteers who, despite the absence of a legal obligation to do so, support civil society for the production of public goods or services that the state or the market has partially or completely failed to provide, as well as the activities of such volunteers should be supported by the tax system.⁵ When the state waives tax revenues by providing tax incentives, it essentially means the collection of higher taxes from other sectors that it continues to tax. However, since the public goods and services produced by civil society benefit the whole society, this cost could be considered as a recompense for the sacrifice made by volunteers from their personal assets through donations.⁶ The relationship between civil society and social benefit was expressed as follows in our early development plans:

"According to today's perception, the state is obliged not only to take measures related to sustenance and authority for ensuring the prosperity of its citizens to the possible extent, but also to prepare the background to realize its objective through economic and financial measures.

2 Erdoğan Sağlam, "Torba yasa ile stopaj oranlarına ilişkin yetki maddelerinde yapılması düşünülen değişiklikler" ("Amendments planned to be made in the authorization articles regarding withholding tax rates under the Omnibus Law"), 13 December 2023, <https://t24.com.tr/yazarlar/erdogan-saglam/torba-yasa-ile-stopaj-oranlarina-iliskin-yetki-maddelerinde-yapilmasi-dusunulen-degisiklikler.42677>

3 Fahri Bakırcı, *Yasalarda ve Yasa Maddelerinde Geçicilik (Temporariness in Laws and Articles of Laws)*, Meclis Bülteni, 2004, p. 41.

4 Richard Steinberg, in *The Routledge Handbook of Taxation and Philanthropy* (ed. Henry Peter & Giedre Lideikyte Huber), Routledge, New York, 2021, pp. 178-198 (hereinafter referred to as the "Routledge Handbook").

5 Richard Steinberg, "Economic Theories of Nonprofit Organizations", in *The Non-Profit Sector: A Research Handbook* (ed. Walter W. Powell & Richard Steinberg), 2. B., Yale University Press, London, 2006, pp. 117- 139.

6 Steinberg, *Routledge Handbook*, p. 193.

As a consequence of this obligation, separate chapters are created in the budget of each state to fulfill its public duty. This public duty is usually financed through taxes. The public services of the state have greatly increased and diversified in accordance with today's social state approach. In such countries, foundations represent an institution that aims to provide direct assistance to public services that the state can scarcely provide or cannot provide at all, through the will of individuals. In countries which have developed into foundation networks, various public services are supported by the old and well-established institution of foundation. This also provides commensurate savings from the budget for the state.⁷

Furthermore, by reducing the tax burden on civil society and volunteers, tax administrations also make a public statement that donations are valuable and worthy of support.⁸ Indeed, extensive studies which have been published in recent years and which compare the tax regulations applicable to civil society organizations in various countries demonstrate that many tax administrations strongly make this statement.⁹ These studies can also help us identify common denominators across countries, understand where we stand, and serve as a reference for the design of new tax rules when the current system needs to be reformed.¹⁰ Therefore, these studies have been employed in all three of our publications where we assess the current state of the fiscal system for associations and foundations and list our recommendations for its reform.

Within the scope of the "The Fiscal/Tax Framework Concerning Civil Society in Türkiye" research (hereinafter, Fiscal/Tax Framework Research), a literature review, a survey involving civil society organizations, in-depth interviews with relevant stakeholders and focus group discussions have been carried out using a methodology that employs a combination of qualitative and quantitative tools. The research aimed to demonstrate the fiscal/tax framework affecting the financial structures of civil society organizations and to assess the impact of the current situation on the overall development of civil society. The research followed three main outlines. Accordingly, the first part of the research focused on the level of knowledge of civil society organizations regarding current fiscal/tax regulations and practices, their perceptions of tax obligations and advantages, their evaluations regarding the legislation and applications, and their suggestions for change. The second main block of the research was the review of fiscal/tax regulations in terms of the activities and sustainability of economic enterprises of civil society organizations. The third part of the research focused on the experiences of civil society organizations with status during the processes of application for such statuses as well as evaluation and supervision, the problems they encounter in benefiting from the advantages provided by the statuses, their perceptions of the statuses in general, and their suggestions for change. The research was conducted using a mixed methodology that employs a combination of quantitative and qualitative methods. In this context, between 17 October 2023 and 2 February 2024, a survey with 124 civil society organizations, in-depth interviews with 30 civil society organizations and 10 experts were conducted and a total of 5 focus groups were held, 4 of which brought together civil society organizations of different categories and scales, and 1 of which brought together financial advisors working with civil society organizations.

7 Prime Ministry State Planning Organization, Specialization Commission Report on Foundations, SPO Publication, Ankara, 1983, p. 14, <https://www.sbb.gov.tr/wp-content/uploads/2022/08/Vakif-Ozel-Ihtisas-Komisyonu-Raporu.pdf>

8 Steinberg, Routledge Handbook, p. 193.

9 See for example, Organization of Economic Cooperation and Development (OECD), Taxation and Philanthropy, OECD Publishing, Paris, 2020; Philanthropy Europe Association (Philea), Comparative Highlights of Foundation Laws: The Operating Environment for Foundations in Europe, Brussels, 2022; European Commission, Comparative Legal Analysis of Associations Laws and Regimes in the EU, Publications Office of the European Union, Luxembourg, 2022; Council on Foundations, Country Notes: Curated Resources for Making Grants Globally, 2024, <https://cof.org/country-notes>.

10 Philea, p. 9.

Legislators would take budgetary requirements into account while implementing our recommendations in respect of the legislation. Two points should be emphasized in this regard. First, in Türkiye, there is no publicly available statistical information that enables calculations relating to the current tax burden of associations and foundations and the burden to be imposed on the budget by possible tax advantages. This situation also makes it difficult for civil society to carry out strong advocacy activities in the financial area. The statements provided by a civil society organization's representative in our qualitative research point to this situation:

"(A)t the end of the day, the state runs on these taxes... How much is the VAT burden of the third sector... The amount of income that the (state) would be waiving and the relief it would provide CSOs in return; these are the items that should actually be compared. If we merely suggest canceling VAT, they may object. But if we say, look, it's only 25 billion liras we are talking about here... Then the matter would be evaluated with precise numbers known, in principle and in terms of how it reflects on the balance sheet, on the state. A whole different story if it's just a drop in the ocean, for example. This requires a very comprehensive work though. I mean, the amounts of VAT collected from all CSOs and foundations would have to be recorded for 2 or maybe 3 years to form a statistic." (Foundation, Large Scale, With Status)

Contrary to the situations where civil society organizations are in end consumer status in terms of value added tax, in cases where organizations file tax returns themselves or tax returns are filed due to the withholding taxes applied while they receive payments, the data is already submitted to the tax administration and is available for use for statistical purposes.

The second point we will underline is the fact that the tax administration does not consider it a necessity to support civil society despite the financial difficulties experienced by civil society. Nevertheless, investors continue to be supported with quite generous tax incentives despite the lack of statistics regarding their effectiveness in our country. It is observed from the statements of a civil society organization's representative in our qualitative research that this different treatment is questioned:

"While we don't have a very large income, economic enterprises are established to generate earnings in line with the purposes and activities of foundations, as you know. Yes, it is a commercial enterprise, subject to (corporate income tax liability). It is not exempt from any tax. So, it is another problem to be paying these taxes additionally, while actually serving the foundation's purposes. I mean, although occasional incentives and practices are introduced for importation or exportation, this sector, which works for the public benefit, is completely ignored. It just doesn't make any sense to me." (Foundation, Large Scale, With Status)

We hope that our three publications titled "Tax Regulations Concerning Associations and Foundations", "Taxation of Economic Enterprises of Associations and Foundations" and "Public Benefit and Tax Exemption Statuses", where we analyze the current situation regarding the fiscal system for associations and foundations, without prejudice to the aforementioned restrictions, and list our recommendations to be used as reference in the design of new tax rules, contribute to the sustainability of civil society in Türkiye.

Introduction

Associations and foundations need resources to operate in line with their purposes of establishment. They obtain these resources from public revenues (public funds and service contracts provided at all administrative levels), donations and aids (donations and aids from the private sector, grants from national associations and foundations, funds and grants from foreign associations and foundations, funds and grants from foreign states and embassies, funds and grants from international organizations such as the United Nations and the European Union, and sponsorship incomes) and/or market incomes (investment incomes, incomes of economic enterprises and membership incomes).¹¹ The composition of these categories in the total income of civil society organizations can vary greatly depending on the type of civil society organization or the country where it is located.¹² The responses given by civil society organizations to the question about the net numerical value of their sources of income in 2022 in the quantitative section of the Fiscal/Tax Framework Research were classified according to the aforementioned categories, revealing that donations and aids constitute the biggest source of income with 60.3%, as indicated in the following table.

Table 1. Distribution of civil society organizations' sources of income

Sources of income	%
Public sector	3.3
Donations and aids	60.3
Market incomes	36.4
Total	100

The fact that market income and economic enterprises' income included therein are present in this composition is important in two respects. First, the 2008-2009 Global Financial Crisis necessitated fiscal austerity policies in many countries. These policies disrupted the upward trend in the share received by civil society organizations from public resources in various countries.¹³ In countries such as Türkiye, where civil society organizations are unable to benefit from public incomes through concrete, continuous and adequate mechanisms,¹⁴ these resources became even more inadequate.

11 Natasha Cortis, "Access to Philanthropic and Commercial Income Among Nonprofit Community Service Organisations", *Voluntas: International Journal of Voluntary and Nonprofit Organizations* 28 (2), 2017, p. 807.

12 OECD, p. 17.

13 Cortis, p. 800.

14 TÜSEV, *Monitoring Matrix on Enabling Environment for Civil Society Development 2020-2021 Türkiye Report*, TÜSEV Publishing, June 2023, p. 84 et seq.

However, there has been an increase in the society's demand for services and meeting their social needs through these organizations. In response, countries began to emphasize in their policies the goal of reducing civil society's need for public revenues and increasing their incomes from donations and aids as well as market incomes.¹⁵

Secondly, studies have shown that diversifying the types of income available to civil society organizations contributes positively to their financial structure and sustainability by reducing financial volatility, spreading risk and maintaining stability.¹⁶ However, this contribution does not follow a regular pattern. For example, in a study conducted in Australia, the contribution of economic enterprises' income to the income composition was found to be more significant in large-scale civil society organizations, while it was determined to be very limited in civil society organizations that are active in the field of children, families and youth.¹⁷

"Today, every NGO must have a functioning economic enterprise in order to ensure its sustainability. This is because, under the current economic circumstances, any organization dependent only on donations would inevitably reach a bottleneck. In other words, that would be a disaster under the current economic conditions. You have to intervene. You are currently employing people. Donations may not come. People may have economic problems. You should not depend only on donations, if you want to continuously and sustainably serve the public good." (Foundation, With status, Large Scale)

"The main motivation of an economic enterprise is always to generate sustainable income. Although a holding structure and similar support exist, it is important for a foundation to diversify its resources and ensure its sustainability so that it can act independently." (Foundation, With status, Large Scale)

It is observed that the use of economic enterprises as a source of income remains limited in Türkiye, despite the two points mentioned above. According to the latest data shared by the Directorate General of Foundations, there were 1,431 for-profit organizations, i.e. economic enterprises, belonging to 5,386 new foundations in 2022.¹⁸ Although there is approximately 1 enterprise for every 4 new

¹⁵ Cortis, p. 821.

¹⁶ Chiako Hung, C., & Mark Hager, "The Impact of Revenue Diversification on Nonprofit Financial Health: A Meta-analysis", *Nonprofit and Voluntary Sector Quarterly*, 48(1), 2019, pp. 5-27.

¹⁷ Cortis, p. 815-816.

¹⁸ Directorate General of Foundations, "Selected Data on New Foundations (2015-31.12.2022)", https://cdn.vgm.gov.tr/genelicerik/genelicerik_945_290519/vakif-istatistikleri/yeni-vakiflar2023-sorasi/13-yeni-vakiflarla-iligili-secilmis-veriler-2015-20.pdf

foundations, only 2.3% of the income of new foundations is sourced from economic enterprises.¹⁹ Similarly, it has been determined that 63.4% of the civil society organizations interviewed as part of the Fiscal/Tax Framework Research do not have an economic enterprise. 30% of associations and 54.5% of foundations have at least one economic enterprise. At this point, it should be noted that the relatively high level of economic enterprise ownership in the research sample compared to Türkiye as a whole is a result of purposive sampling aimed to thoroughly identify the experiences in this field. It is observed that ownership of economic enterprises increases for both legal statuses as the level of income increases. Accordingly, 36.9% of associations with an annual income of 500 thousand TL or more have an economic enterprise, while 78.6% of foundations with an annual income of 5 million or more have at least one economic enterprise.

As for the main reasons why organizations prefer not to establish economic enterprises, the quantitative phase of the Fiscal/Tax Framework Research reveals that 38.5% do not consider it necessary to establish one and 34.6% find bureaucratic obligations too burdensome. Furthermore, other important reasons preventing the establishment of an economic enterprise include insufficiency of organizations' capacity (19.2%) and the closure of an existing economic enterprise due to loss or termination of the relevant activity (7.7%). A lower rate of organizations (1.3%) indicated closure as a result of an audit by the public administration as the reason.

Table 2. Reasons for not establishing an economic enterprise in civil society organizations without economic enterprises (multiple choice)

Reasons	Per Cent (%)
Burdensome bureaucracy and obligations	34.6
We did not consider it necessary to establish one	38.5
We do not have the capacity to establish one	19.2
We had one, but we closed it at our discretion (due to reasons such as loss, termination of the relevant activity, etc.)	7.7
We had one, but it was closed as a result of an audit by the public authority	1.3

The findings of our qualitative research, on the other hand, point to increased business complexity and risk, increased administrative costs and financial and formal tax burden as the reasons behind this low rate.

"As you know, establishing an economic enterprise is no different from establishing any commercial enterprise. There are establishment costs and then ongoing tax costs in the process... The process reaches a bottleneck if there are no sales. We thought we would even receive penalties on top of it and put our directors under risk. So, we have been reluctant to do it..." (Association, With Status, Medium Scale)

¹⁹ Ibid.

“The motivation and dynamics of civil society and the economic enterprise established to create and support financial sustainability are actually two very different formations. You have to dedicate all your existing resources and experience; I am not just talking about financial resources. It is a completely different effort to establish the economic enterprise system, maintain its order and monitor it with all your resources.” (Foundation, With status, Large Scale)

I have been saying that for years. It's no different than a company. It is subject to every obligation. Advance tax returns in every 3 months. I think the declaration liabilities are excessive and burdensome. You know, you have to declare all taxes in April, in addition to corporate income tax. The monthly VAT, withholding tax return. SGK, BaBs. I think it is ridiculous. Tax after tax. Tax return after tax return. Once you complete a cycle, a new one begins. You restart the same cycle every month. I think it's also excessive and burdensome financially. It is burdensome in terms of taxes and procedures as well. Sometimes you have to postpone your own business because you are too busy with tax returns. You may have to move your business to the back burner. There is a constant effort to file tax returns, calculate taxes, meet some requirements, check some things. There are monthly financial advisor audits. For years, I have been thinking that these impose quite a heavy burden on economic enterprises.” (Focus group interview (1), Foundation, With Status, Large Scale)

“We strive very hard to make profits. We are already profitable. We already face problems when there is no profit. Our goal is to generate money for the foundation from the economic enterprise. That is why it is profitable. But how? What does happen actually? Foundation employees also perform at the economic enterprise. I mean they work for it as well. In other words, economic enterprises are equivalent to joint stock companies; they do not have a separate general directorate. The same employees, the same financial affairs (employees) also keep the accounts of the economic enterprise. They also perform the marketing, resource development and so on. That's why it's a bit tiring, that's the biggest reason.” (Foundation, With status, Large Scale)

There are two prominent aspects regarding the tax burden on economic enterprises of associations and foundations. First, economic enterprises owned by or affiliated to associations and foundations are considered as corporate income taxpayers in our legislation. They are subject to the same provisions as other enterprises and do not benefit from any corporate income tax advantage since they are owned by or affiliated to associations and foundations. Despite this burden, when an economic enterprise established to achieve their purposes by associations and foundations incurs loss, transfers to be made by them to recover the loss are not accepted as expenditures incurred for the purpose by our legal system. Thus, those who hold the status of public benefit association or tax-exempt foundation are at risk of failing to meet the requirement for foundations to “spend at least two-thirds of their annual income within the year in which it is generated” and for associations to “spend at least half of their annual income for this purpose” in order to maintain their status. Secondly, in practice, economic enterprises that transfer their profits remaining after corporate income tax to associations and foundations may also be required to apply income withholding tax. This further aggravates the tax burden of associations and foundations.

These two aspects constitute the two main parts of the study.

I. Corporate income tax liability of economic enterprises

1. Formation of economic enterprises

Corporate income tax is levied at 25% on the income of the corporations listed in the law (CITL, 1, 32). The term "corporation" may have the connotation of a legal entity for persons who are not familiar with the field. However, while associations and foundations, which are legal entities, are not considered as corporate income taxpayers, the economic enterprises established by them, which do not have a separate legal personality, are listed among corporate income taxpayers (CITL, 2/5). Considering the characteristics of such taxpayers, the legislator states as follows: "The tax liability of economic enterprises belonging to associations or foundations is not affected by the fact that they do not pursue profits, that their activities are among the duties assigned by law, that they do not have legal personality, that they do not have independent accounting and that they do not have their own capital or workplaces. The fact that the price of goods or services is only sufficient to cover the cost, that there is no profit or that the profit is allocated to the purpose of their establishment does not change their economic nature" (CITL, 2/6).

Even if an association or foundation has not officially established an economic enterprise, they are deemed to own an economic enterprise and their corporate income tax liability is deemed to start when they meet certain conditions.²⁰ These conditions are as follows:

- Being owned by or affiliated to an association or foundation (ownership refers to capital, while affiliation refers to administrative affiliation),
- Not being established as a capital company or cooperative (in this case, they would be subject to tax separately as a capital company or cooperative instead of an economic enterprise owned by an association or foundation),²¹
- Continuous activity in the commercial, industrial or agricultural fields (i.e. the participation of this enterprise in the circulation / market economy, in other words, sales of the goods produced in or purchased by the enterprise or services provided by the enterprise for a price) (CITL, 2/5; CITL General Communiqué Series No. 1, 2.4).²²

In cases where associations and foundations do not register corporate income tax liability for their economic enterprises despite these conditions, or the tax office resorts to establishment of corporate income tax liability on the grounds that an economic enterprise is formed, as a result of an inaccurate

²⁰ According to the Directorate General of Foundations, foundations have few economic enterprises registered in the trade registry. On the other hand, there are many economic enterprises of associations and foundations which are deemed to have been formed and for which corporate income tax liability is established by the tax administration. However, since they are not registered in the trade registry, their exact number is not known by the Directorate General of Foundations.

²¹ Their distribution of profits to associations and foundations with shareholding interests are treated separately from the discussions in the 2nd section and is subject to withholding tax. For an example tax ruling, see Revenue Administration Ankara Tax Office Directorate Income Laws Income Taxes Group Directorate, "Whether income withholding tax is applicable to the dividends transferred to the foundation" (1705.2022), <https://www.verginet.net/dtt/11/ozelge-2022-3.aspx?ozid=3497>

²² See. Ahmet Kirman, "Vakıfların Vergilendirilmesinde Vergi İdaresinin Yeni Yaklaşımları ve Geçerliliği" ("New Approaches Adopted by the Tax Administration to the Taxation of Foundations and their Validity"), in Mualla Öncel'e Armağan, Vol. 1. Ankara University Publishing, Ankara, 2009, p. 427-455.

application of these conditions, the financial burden on associations and foundations is aggravated due to the taxes assessed ex-officio (i.e. tax receivables calculated and determined over tax bases identified by the administration), as well as the penalties imposed. The tax administration should examine the existence of all the aforementioned conditions and particularly determine whether there is an activity aimed at participating in the market economy. For instance, in the example provided in Section 2.4 of the Corporate Income Tax Law General Communiqué Series No. 1, the Ministry of Finance considers “engaging in securities trading activities of an extent that requires the employment of a separate staff and employing staff exclusively for this activity” sufficient for the existence of an economic enterprise. However, the employment element, thus the transaction volume criterion are not suitable for qualification as an economic enterprise and the aforementioned example is criticized in the literature due to its unlawful nature.²³ Otherwise, the high volumes of income from movable property gained by natural persons would also have to be considered and taxed as commercial earnings, as in the case of associations and foundations.²⁴

2. Exclusion of economic enterprises or some of their income from taxation

According to the Statement of Justification of the former Corporate Income Tax Law dated 3 June 1949 no. 5422, which constitutes a step towards modern taxation, economic enterprises of associations and foundations are included among corporate income taxpayers for the reasons that require the taxation of public economic institutions, especially due to account keeping and accountability.²⁵ Today, economic enterprises of associations and foundations are taxed with a focus on the idea of equal treatment of the enterprises, which is listed among the reasons for the taxation of public economic organizations, and protection of the competitive environment and economic harmony by not granting tax privileges. During the qualitative interviews, this issue was explained by the experts as follows:

“If a CSO engages in an activity that interferes with commercial life and opens an economic enterprise, it would be taxed so that unfair competition is prevented. For example, they can open a clubhouse. When (associations and foundations) want to set up such enterprises, they are told that they are not corporate income taxpayers and they should establish an enterprise and become corporate income taxpayers. Businesses such as cafes, artificial turf fields, spas, restaurants, student dormitories must be taxpayers.” (Revenue Administration, Bureaucrat Opinion)

²³ Kırman, p. 436 et seq. As an example for the tax rulings where the tax authority adopts this view, see Revenue Administration Istanbul Tax Office Directorate Income Laws Income and Corporate Income Taxes Group Directorate, “Whether Eurobond Interest Incomes and Trading Gains Derived by the Foundation must be Declared” (04.08.2020), <https://gib.gov.tr/vakif-tarafindan-elde-edilen-eurobond-faiz-geliri-ve-alim-satim-kazanclarinin-beyan-edilip>

²⁴ See. Mehmet Maç, Dernek ve Vakıfların Faiz, Repo ve Benzeri Finansman Giderleri (Interest, Repo and Similar Financing Expenses of Associations and Foundations), Vergi Sorunları, No. 145, 2000, p. 57.

²⁵ GNAT, 5422 sayılı Kurumlar Vergisi Kanunu Tasarısı ve Geçici Komisyon Raporu (1/173) (Draft Corporate income tax Law no. 5422 and the Provisional Commission Report (1/173)), p. 4, <https://www5.tbmm.gov.tr/tutanaklar/TUTANAK/TBMM/d08/c018/tbmm08018078ss0146.pdf>

"(Economic enterprises of associations and foundations) are corporate income taxpayers, ... operate in competition with other actors in the market, so the incentives for them have to be a little more limited anyway. ...A competitive inequality... would lead to a change in the organization chart in the economy... For example, if you cannot keep a group under control or fail to make good arrangements, the composition of the company would turn in their favor. So, it would affect competition negatively." (Ministry of Treasury and Finance, Tax Inspection Board Directorate, Bureaucrat Opinion)

On the other hand, while there is no consensus, there are some representatives of civil society organizations who believe that providing some tax advantages to economic enterprises will not lead to competitive inequality, to the extent that they are supervised.

"Such economic enterprises are not established for profit. The economic enterprise of a special education institution is not in a position to compete with a normal institution anyway." (Foundation, With status, Large Scale)

"First of all, their subject matters are different. I mean the resources and potential of the private sector are not the same as those of civil society... Their goal is not to sell more goods, but rather to produce more services." (Association, Without Status, Small Scale)

"I do not agree with the view that such tax advantages would have negative impacts. And why not? Because the affairs of the civil society are quite specific. I am giving you an example particularly in this field. How many foundations or associations are there that provide health services or vacation services through an economic enterprise? ... (on the contrary) I think it would be an advantage rather than a disadvantage. In this sector, I mean in my own business, I sell souvenirs. When the companies that sell souvenirs buy it from me and ...intend to provide some help, some benefit in doing so, they would be developing awareness and social responsibility from their perspective. Therefore, I think it would benefit the sector." (Foundation, With status, Large Scale)

"When we carry out an activity, we try to utilize economic enterprises of other civil society organizations even if we are to purchase a gift, something small... Why do we do that? So that we can support other civil society organizations while increasing people's awareness of such activities... There is nothing challenging about it for the free market economy. When you look at their processes, you can see that they do not have really big capacities, engage in very big activities anyway. I do not think there is anything that would create problems in that respect." (Association, Without Status, Medium Scale)

"I do not think there would be any problems related to competition, as long as they do so under supervision." (Financial Advisor)

Moreover, in our qualitative research, a representative of a civil society organization pointed to the disadvantageous position of economic enterprises of associations and foundations compared

to commercial enterprises established to operate in the market economy, emphasizing that a tax advantage could mitigate this competitive inequality against them.

“Actually it is the other way around. We are at a disadvantage because we do not know the market. I am trying to sell toys... I produce them myself. I know that 3-6 year old children will be interested in them. But I do not have the ability, the capacity to sell them... I sell them only to the extent that I can promote them. However, other companies are more advantageous than me. Maybe their prices are higher than mine, but they know the market and operate in it. They are actually more advantageous than me strategically as well. I am always at a disadvantage compared to them. I can never get ahead of them and gain advantage. If I sell my products at higher prices, then no one would buy them, and I can not sell them at loss anyway. It is already written in the foundation’s statute. The charter states that members of the board of directors are responsible for any transaction conducted at a loss. The rule applies to the economic enterprise as well. Even any kind of pricing that I apply will always put me at a disadvantage. I never have anything to get ahead of them.” (Foundation, With status, Large Scale)

It is observed from examples around the world that many countries tax civil society organizations’ gains and revenues generated from commercial activities in order to maintain competitive neutrality.²⁶ However, they often make a distinction between commercial activities which are related or unrelated with the civil society organization’s purpose (i.e. related commercial, business or trading income/unrelated commercial, business or trading income) and provide tax concessions for related commercial activities.²⁷

France, Hungary, Ireland, Luxembourg and Portugal grant tax exemption if an economic enterprise’s activity is related to the purpose of the civil society organization, whereas they tax unrelated economic activities.²⁸ Similarly, in the United States, business activities of tax-exempt civil society organizations that are substantially related to this status are excluded from taxation and the net income from unrelated activities is subjected to a tax called “unrelated business income tax” (UBIT) at a rate similar to corporate income tax.²⁹ Furthermore, the country also excludes investment income such as dividends, interest, license fees and real estate rent from the unrelated business income tax.³⁰ Germany, on the other hand, not only does not tax income from related economic activities, but also does not tax annual income from unrelated economic activities unless it exceeds EUR 45,000.³¹ In fact, Australia and New Zealand do not recognize such a competitive neutrality problem at all and have completely excluded the earnings generated by non-profit organizations from their business activities from income taxation.³²

Thus, many countries have recognized the importance of income from economic activities for the financial sustainability of civil society organizations, in addition to donations and aids, which are among special incomes, and the management of current assets. However, they have balanced

²⁶ OECD, p. 31.

²⁷ Ibid.

²⁸ Philanthropy Europe Association, p. 36.

²⁹ Internal Revenue Service, “Publication 598: Tax on Unrelated Business Income of Exempt Organizations”, March 2021, <https://www.irs.gov/pub/irs-pdf/p598.pdf>.

³⁰ Ibid.

³¹ Philanthropy Europe Association, p. 30.

³² OECD, p. 58.

these two legitimate interests by imposing certain limitations to prevent disrupting the competition in the market.³³ The findings of our qualitative research reveal that civil society organizations in Türkiye expect a distinction between commercial activities which are related and unrelated with the purposes of establishment in terms of taxation.

"Of course, most organizations have to establish economic enterprises. And when they don't... Any activity for generating the smallest income turns into an economic enterprise. I think the critical issue here is that the state considers every economic enterprise as a commercial enterprise established to serve the foundation's purposes. However, there are some that are and some that are not. For example, (the dormitory enterprise of an educational organization) is both a service related with the purpose... and makes money. It is great that it generates income. I wish taxes were not paid from it... I wish more children could receive education, stay in dormitories or new dormitories could be built with that money. Because in the end, all these are essentially public services. But their point of view is exactly as I explained. Let me give you an example...suppose that a foundation generates income from its fuel enterprise to contribute to the armed forces. The business carried out here is not related with the foundation's purpose at all. I mean it is clear and obvious that it is a commercial enterprise. But our case is different. We provide rehabilitation services for the disabled. We provide school services for the disabled. We provide counseling services for families, for the disabled. These activities, by nature, are not likely to ever generate income, that is profits, in any way. Because we do not reflect all our costs on the families. That is impossible. That would contradict with the foundation's purpose. Therefore, all our economic enterprises incur loss. Now ... unless this distinction is clearly made and a permanent solution is introduced in this regard, we will continue discussing these matters forever." (Focus group interview (3), Foundation, With Status, Large Scale))

According to the responses received to the quantitative part of the Fiscal/Tax Framework Research, 49.6% of civil society organizations with economic enterprises believe that the conditions for considering their income-generating activities as economic activities should be associated with the amount of income generated, rather than the frequency of the activity. This belief is consistent with the view that some of the income generated by economic enterprises should be excluded from tax.

On other hand, in the current tax system in Türkiye, the need for such a balance is disregarded and economic enterprises of associations and foundations are subject to the same corporate income tax regulations as other commercial enterprises. However, the former Corporate Income Tax Law No. 5422 dated 3 June 1949 had granted certain tax concessions even when including economic enterprises of associations and foundations within the scope of corporate income tax.³⁴ Under the Article 7 of the Law, which regulated tax-exempt corporations, all economic enterprises that were approved and certified by the relevant ministries to be operated for specific purposes by all associations and foundations were exempted from corporate income tax. These included the following economic enterprises:

- Schools, school workshops, conservatories, general libraries, theaters, museums, exhibitions, sample nurseries, seed and animal breeding and breeding stations, racetracks and similar enterprises operated for the purpose of teaching, disseminating, improving and promoting science and fine arts, agriculture and animal husbandry,
- Hospitals, convalescent homes, clinics, dispensaries, preventoriums, sanatoriums, child care facilities, animal hospitals and dispensaries, animal care facilities, veterinary bacteriology

³³ Philanthropy Europe Association, p. 30.

³⁴ OG: 10.06.1949; 7229.

and serology, dystophagy, and similar enterprises operated for the protection and treatment of general human and animal health,

- Enterprises operated for social purposes such as compassion, pawn and aid funds, soup kitchens, workshops of penal and correctional institutions, workshops of hospices, social insurance institutions, student dormitories and hostels.
- Local, national and international exhibitions, fairs and festivals set up with the permission of the government and competent administrative authorities.

Subsequently, under the provision added to the Article 7 of the former Corporate Income Tax Law No. 5422 by the Law No. 199 dated 18 February 1963, clubhouse, music hall and restaurant enterprises belonging to associations and exclusively allocated for the benefit of their members, were deemed exempt from tax on the condition that they did not serve alcoholic beverages.

The Law no. 903 dated 13 July 1967³⁵, which laid the foundations for the modern law on foundations, rearranged the foundation institution while also introducing tax-related provisions. "Foundations granted tax exemption by the Council of Ministers" were added to the exempt corporations listed in the article 7 of the former Corporate Income Tax Law no. 5422. Thus, the general corporate income tax exemption, which was not granted to the economic enterprises of associations working for the public benefit, i.e. associations with status, was granted to the economic enterprises of foundations with status. The tax-exemption status was mainly based on the allocation of 80% of the foundation's income to public service. An official working for the Ministry of Finance at the time expressed this link as follows:

"Granting tax exemption to foundations involves direct transfer of tax income to foundations by not taxing foundation enterprises that are subject to taxation. In return for the waiving of tax incomes through tax exemption, foundations perform public services of an amount equal to the tax amount supplied."³⁶

After 1967, the number of foundations increased dramatically. However, the administration could not effectively examine and determine whether the requirement of allocating 80% of foundation incomes to public service was being fulfilled, leading to suspicions that the tax exemption was being abused and the treasury was losing revenue. In the 1980s, policymakers began to discuss two options regarding the issue.³⁷ The first was to abolish the general tax exemption of foundations with status. The second was to limit the tax exemption to foundations established for educational, cultural and health purposes. As a result of lengthy discussions, the parenthetical clause "This exemption does not cover the economic enterprises of foundations" was added to the provision "Foundations granted tax exemption by the Council of Ministers" in the Article 7 of the former Corporate Income Tax Law No. 5422, under the Law no. 3824 dated 1992. Thus, the general tax concession granted to economic enterprises of foundations with status ceased to exist. On the other hand, earnings generated by foundations with status from their economic enterprises established for the purposes of education, health, culture and scientific research and development were excluded from taxation, under the 19th clause added to the Article 8 of the Corporate Income Tax Law by the same law. Accordingly, the second option was exercised. Shortly afterwards, this exemption was also abolished, as per the Law No. 3946 dated 26 December 1993, marking the end of the regime that allowed foundations with status to benefit from advantageous corporate income tax treatment on the condition that they incurred expenditures for

35 OG: 24.07.1967, 12655.

36 Prime Ministry State Planning Organization, Specialization Commission Report on Foundations, SPO Publication, Ankara, 1983, p. 24, 84.

37 Ibid. p. 104.

charitable purposes. As mentioned earlier, in the current system, associations and foundations are subject to the requirement of spending a certain amount of their income each year in order to maintain their status. However, the privileges offered to associations and foundations by the fulfilment of these requirements have become limited to tax deductions granted to donors to these foundations and some tax advantages other than income and corporate income tax.

On the other hand, the regulation under the Article 7 of the Corporate Income Tax Law, which exempted certain economic enterprises of all associations and foundations from corporate income tax, was repealed by the Law No. 4369 dated 29 July 1998.

The only main provision regarding the economic enterprises of associations and foundations with status, which was added to the new Corporate Income Tax Law No. 5520 by the Law No. 5228 dated 16 July 2004, and which is still effective today, is the corporate income tax exemption granted for a limited period to the earnings derived from the operation of rehabilitation centers affiliated to them for five accounting periods, within the framework of the procedures to be determined by the Ministry of Finance by obtaining the opinion of the relevant Ministry (CITL, 5/1-ı).

On the other hand, a temporary exemption is stipulated for the economic enterprises of associations and foundations, under the temporary Article 2 which was added to the new Corporate Income Tax Law no. 5520 by the Law no. 5766 dated 4 June 2008 and whose effective period was extended until 31 December 2025 with a revision³⁸. The provision states that:

“An economic enterprise shall not be deemed to have been established... due to gains and earnings which are generated by associations and foundations between 1/1/2008-31/12/2025... and which were taxed through withholding under the clause (5) of the Article 94 and the temporary Article 67 of the Income Tax Law.”

The clause 5 of Article 94 of the Income Tax Law regulates real estate rental income, while the temporary Article 67 regulates interest income and earnings from security trading. The generation of these incomes by associations and foundations does not result in the establishment of an economic enterprise as a rule.³⁹ Associations and foundations will benefit from this exemption provision if the generation of such incomes constitutes a commercial activity. An interpretation of the Canadian tax administration regarding when a real estate leasing conducted by an association or foundation would constitute a commercial activity serves as a guide to understand the matter.⁴⁰ The Canadian tax administration states that, in the determination of whether the real estate leasing by a civil society organization constitutes income from immovable property or commercial earnings, i.e. economic enterprise earnings, the nature and degree of participation in the said activity should be taken into account.⁴¹ Accordingly, if the association or foundation provides additional services such as individual office cleaning or security, in addition to the basic services such as cleaning of common areas, heating/cooling services, elevator and parking area, which are provided customarily with the delivery of the real estate, a commercial activity would exist.⁴² These additional services indicate that the association or

³⁸ Law dated 11 November 2020 no. 7256 on the Restructuring of Certain Receivables and Amendment of Certain Laws (OG: 17.11.2020: 31307).

³⁹ Maç, p. 57; Kirman, p. 444. Kirman criticizes the temporary Article 2 added to the Corporate Income Tax Law, since it creates the impression that an economic enterprise shall be deemed to be established automatically due to such earnings, regardless of the conditions, after 31 December 2025, *ibid*.

⁴⁰ See. Canada Revenue Administration, “Classifying income earned by registered charities from their rental of real property to others”, 23 March 2018, <https://www.canadiancharitylaw.ca/wp-content/uploads/2022/04/CRA-Guidance-Classifying-income-earned-by-registered-charities-from-their-rental-of-real-estate.pdf>

⁴¹ *Ibid*. p. 1.

⁴² *Ibid*. p. 2.

foundation participates in the market economy. The number or size of the leased real estate or the time spent by the CSO for the management and supervision of the basic services related to this lease are not criteria that can be used to qualify the activity as a commercial enterprise.⁴³ In this respect, it is not possible to agree with the comments provided by our tax administration in the tax ruling shown in the following table, according to which a leasing activity can be automatically qualified as a commercial enterprise based on the volume and significance of the real estate pertaining to an association.

Table 3. Tax ruling regarding the taxation of the association's real estate rental income⁴⁴

In the section 15.3.2.3 of the Corporate Income Tax General Communiqué No.1 titled "Rental Payments Made in Return for the Lease of Immovable Property Belonging to Other Corporate Income Taxpayers", it is stated that withholding tax shall not be applied to the rental payments made in return for the lease of immovable property belonging to the corporate income taxpayers (except cooperatives) listed in the Article 1 of the Corporate Income Tax Law; the rental income obtained by these corporations shall be declared with the corporate income tax return of the relevant accounting period, and that in case the lease of immovables belonging to associations and foundations leads to the formation of an economic enterprise, withholding tax shall not be applied to the rental income obtained, since the economic enterprise to be formed is a corporate income taxpayer.

*According to these provisions, in case the real estate of your Association is leased for commercial purposes **or within the scope of an organization that requires commercial methods and procedures in terms of volume and significance, this leasing activity would lead to the formation of an economic enterprise affiliated to your Association.** Therefore, income withholding tax would not be applicable to the rental payments to be made due to the real estate leased within the economic enterprise and the rental income would have to be declared through your economic enterprise's corporate income tax return of the related accounting period. However, in case the real estate is leased to those who are obliged to apply withholding tax under the article 93 of the Income Tax Law, without affiliation to a commercial organization such as setting up a workplace or personnel employment, an economic enterprise affiliated to your Association would not be formed. Therefore, the withholding tax applied to the said rental payments would be the final taxation.*

However, corporate income tax liability would not be registered if the rental income from your Foundation's real estate are taxed through withholding as per the provision under the Temporary Article 2 of the Corporate Income Tax Law no. 5520, which states that an economic enterprise shall not be considered to have been formed due to the gains and revenues which were acquired by associations and foundations between 1/1/2008-31/12/2015 and which have been taxed through withholding under the Temporary Article 67 and the clause (5) of the Article 94 of the Income Tax Law.

On the other hand, in the event that an economic enterprise is formed within an association or foundation for reasons other than the incomes specified above, the income from the lease of the immovable property that is generated from the lease of the immovables registered in the economic enterprise's assets or the incomes generated from the purchase-sale, retention or redemption of the securities registered in the economic enterprise's assets (regardless of whether they have been taxed through withholding) would be included in the earnings of the said enterprise and subjected to corporate income tax."

⁴³ Ibid.; Maç, p. 57.

⁴⁴ Revenue Administration Muğla Tax Office Directorate Taxpayer Services Procedural Directorate, "Taxation of the association's real estate rental income" (18.12.2010), <https://www.ozdogrular.com/v1/content/view/28179/257/>.

II. Status of transfer of economic enterprises' profits to associations or foundations in terms of income withholding tax

Transactions where the economic enterprises of associations and foundations transfer their profits after corporate income tax to the association and foundation do not constitute profit distribution. Therefore, such transfers should not be subject to the 10% withholding tax stipulated for profit distribution under the clause 6-b-i of the Article 94 of the Income Tax Law. Nevertheless, whether the relevant provision should be applied is still debated. It has been stated in the literature that this is not possible under the current regulations.⁴⁵ The tax administration, on the other hand, persistently maintains its view that withholding tax should be applied in this case.⁴⁶ In fact, according to the quantitative research findings of the Fiscal/Tax Framework Research, 60% of associations and foundations complain about the unlawful taxation resulting from their obligation to pay 10% income tax on the profits transferred to them by their economic enterprises.

While all chambers of the Council of State shared the same interpretation with the tax administration for many years,⁴⁷ the 4th Chamber of the Council of State has recently reversed this case law and started to rule in favor of economic enterprises of associations and foundations. In one of its decisions, the 4th Chamber concluded that there is no participation relationship between the foundation and its enterprise, and therefore, the transfer of profits by an enterprise to its owner foundation cannot be taxed by being deemed as dividends arising from the participation. According to the statement of justification:

"Although the Article 75/2 of the Income Tax Law lists earnings arising from participation shares among income from movable property, it does not provide a definition of participation shares. In the CITL General Communiqué No. 49, participation shares are defined as share certificates of joint stock companies, participation shares of limited liability companies, partnership shares belonging to the commanding partners of limited partnership companies and partnership shares belonging to business partnerships and ordinary partnerships.

45 Maç, p. 56.

46 Revenue Administration, Guidelines on the Taxation of Associations, GİB Publishing, Ankara, 2012, p. 17; Revenue Administration, Guidelines on the Taxation of Foundations, GİB Publishing, Ankara, 2012, p. 11; Revenue Administration Ankara Tax Office Directorate Taxpayer Services Income Taxes Group Directorate, "Treatment of the income transferred to the foundation by its economic enterprise as profit distribution." (25.03.2010); Revenue Administration Samsun Tax Office Directorate Taxpayer Services Income Taxes Group Directorate, "Income withholding tax in the transfer of the profits of the foundation's economic enterprise to the foundation." (27.20.2010); Revenue Administration Istanbul Tax Office Directorate Taxpayer Services Procedural Group Directorate, "Income withholding tax in the transfer of the profits of the association's economic enterprise to the association; order of documentation in the donations made to the association's legal personality." (06.06.2013), <https://www.gib.gov.tr/node/99800>.

47 For exemplary decisions, see. 3rd Chamber of the Council of State, E.2016/3658, K.2017/7030, 12.10.2017; 4th Chamber of the Council of State, E. 2003/948, K. 2004/432, 09.03.2004; 4th Chamber of the Council of State, E. 2014/881, K. 2018/7565, 13.09.2018; 4th Chamber of the Council of State, E. 2015/5884, K. 2017/2931, 23.03.2017.

As it can be seen, economic enterprises of foundations are not listed as "participation shares". The concept of participation is defined in the General Communiqué on Uniform Accounting System Implementation as follows: "Participations are the accounts where the shares or partnership interests acquired by an entity to directly or indirectly participate in the management of other companies and in the determination of partnership policies are recognized."

Participation gains refers to profit shares acquired by an entity in return for its participation share in the capital of another entity. Therefore, in order to receive participation gains, two separate legal personalities must exist and an entity must participate in another entity by having partnership, shareholding and share certificates.

In this case, in order to accept that profit distribution exists under the article 94 of the Income Tax Law no. 193, there must be two separate entities with legal personality, and there must be a relationship of participation based on the presence of "share certificates" or "participation shares" between the legal entities.

In the event in question, although the plaintiff foundation and its economic enterprise do not have separate legal entities, the economic enterprise is an entity within the legal entity of the plaintiff foundation. In this respect, since there cannot be a participation relationship within the same legal entity, the amount transferred by the economic enterprise to the foundation cannot be considered as dividend, nor can it be considered as participation gains for the foundation.

In this case, since the amount transferred by the economic enterprise affiliated to the plaintiff foundation is not an income arising from participation shares in the sense stated in clause 2, subparagraph 1 of the Article 75 of the Income Tax Law, the application of withholding tax under the clause 6/b-i of the Article 94 of the Income Tax Law is not lawful. Therefore, the decision taken by the Tax Court has not been determined to be in line with the law."⁴⁸

In another decision, the same Chamber emphasized that if the legislator had intended to tax the profit of an enterprise, which must be transferred to the association that owns the enterprise unless the enterprise adds it to the capital as per the legislation, they would have done so by explicitly specifying it in the relevant provision; however, the legislator preferred to exclude the profit transfer from taxation by not doing so. According to the decision taken in favor of the association's economic enterprise:

48 4th Chamber of the Council of State, E. 2016/14002, K. 2019/2532, 03.04.2019.

“Although economic enterprises of associations and foundations that do not have legal personality are considered as separate tax subjects as corporate income taxpayers, they are managed by the foundation or association to which they are affiliated and separate tax returns are filed for each economic enterprise of associations and foundations, by the legal entities they are affiliated to, and associations and foundations. Their whole capital is also allocated by the relevant association or foundation. On the other hand, the Corporate Income Tax General Communiqué series no. 83 states that the net profit remaining after deducting the required taxes from the profit of the economic enterprise will be transferred to the foundation’s budget as income.

The clause 94/6-b-i of the Income Tax Law refers to the article 75, stating that withholding tax shall be applied only to the profit shares specified in the clauses 1, 2 and 3 of the second paragraph and the Article 75/2 lists earnings arising from participation shares as income from movable property; however, tax laws do not provide a definition of participation share. It is only stated in the parenthetical section of the clause 2 of the aforementioned Article 75 that the profit shares of limited companies’ shareholders, business partners and partners with limited liability, as well as the profits distributed by cooperatives are in the nature of profits arising from participation shares, and the distribution of the profits arising from the transactions conducted by cooperatives with their shareholders to the shareholders in proportion to their transactions with the cooperative shall not be considered as profit distribution. There is no explicit regulation stating that the transfer of profits derived from the economic enterprises of associations or foundations to the account of the association or foundation is considered as participation gains.

In this case, given also the presence of a general regulatory procedure requiring associations’ economic enterprises to transfer their earnings to their respective associations, the transaction where the economic enterprise transfers its profits to the account of the legal entity of the association or foundation to which it is legally affiliated and belongs, may not be considered as a profit distribution transaction by nature; furthermore, the transfer of such profits is not listed among the profit shares subject to withholding tax either. Therefore, the withholding tax imposed by accepting the profits that are transferred to its owner association by the plaintiff economic enterprise as participation gains from the association’s perspective should be cancelled and the lawsuit filed with the request for refund of the amount paid together with interest should be accepted, while the Court decision ruling its dismissal is not lawful.”⁴⁹

Nevertheless, the 3rd Chamber of the Council of State maintains the former case law.⁵⁰ Divergence in the case law undermines legal security and violates the principle of the rule of law in practice.

49 4th Chamber of the Council of State, E. 2016/21490, K. 2021/1861, 25.03.2021. For similar decisions, see. 4th Chamber of the Council of State, E.2018/5142, K.2022/1412, 09.03.2022; 4th Chamber of the Council of State, E.2019/5597, K.2022/3983, 14.06.2022; 4th Chamber of the Council of State, E. 2022/4801, K. 2022/7839, 14.12.2022; 4th Chamber of the Council of State, E. 2020/2369; 2023/2957, 30.05.2023; 4th Chamber of the Council of State, E. 2021/253, 2023/2958, 30.05.2023; 4th Chamber of the Council of State, E. 2022/2895, K. 2022/3986, 14.06.2022; 4th Chamber of the Council of State, E. 2018/6444, K. 2022/5401, 16.10.2022; 4th Chamber of the Council of State, E. 2019/5206, K. 2022/3501, 01.06.2022; 4th Chamber of the Council of State, E. 2019/3893, K. 2022/1624, 16.03.2022.

50 See. 3rd Chamber of the Council of State, E.2019/639, K.2022/1024, 09.03.2022; 3rd Chamber of the Council of State, E.2022/2156, K.2023/899, 21.03.2023; 3rd Chamber of the Council of State, E.2022/1846, K.2023/901, 21.03.2023.

III. Recommendations

1. Corporate income tax concession should be granted for the income of economic enterprises of civil society organizations.

Economic enterprises of associations and foundations that operate in line with their objectives should be distinguished from commercial enterprises established to operate in the market economy and should be provided with a tax concession where they are exempt from corporate income tax completely or for a certain amount of their earnings.

“Economic enterprises are subject to all tax liabilities, but at the end of the day, the profit they generate benefits the foundation. So... they have the same purpose... despite carrying all tax implications. I think that since its purpose is the same, the structure should be the same as well. They serve the same purpose... I don't know if it is right to separate them tax-wise. We can continue declaring them. We can declare our activities, The amount of our sales, the amount of our profit. But it is not right for the state to collect it from us in cash. What they do not collect, I transfer to the foundation, that is, the activity carried out there. They have a clear purpose: earning income. Unfortunately, since the purpose of a civil society organization is to continue its activities without deriving profits, the purpose of an economic enterprise cannot be considered as deriving profits either. It may be written in the law as such. But making profit is not its actual purpose. Its purpose is to serve the foundation, to serve the foundation's or association's activities. I do not find it just to collect so many taxes and to impose such liabilities on an organization which does not operate for such purposes.” (Foundation, With status, Large Scale)

2. A clear provision should be added to the law stating that income withholding tax is not applicable to the transfer of profits by economic enterprises to their associations or foundations.

A discrepancy in case law has occurred between the 3rd Chamber of the Council of State and the 4th Chamber of the Council of State regarding whether withholding tax shall be applied to the profits transferred by economic enterprises to associations and foundations. This discrepancy is contrary to the principles of legal security and the rule of law. The Grand National Assembly of Türkiye could establish an original norm and amend the parenthetical provision of the Article 94/6-b-i of the Income Tax Law as “the addition of profit to capital (and transfer of profits by the economic enterprises of associations and foundations to the association and foundation) shall not be considered as profit distribution”. In any case, the Council of State has the duty to resolve this contradiction through a decision and to ensure unity of case law. Our law contains a practice of unifying case laws in this regard (the Law No. 2575 on Council of State, Articles 28, 39 and 40).

3. When an economic enterprise incurs loss, the transfer of resources made by the association and foundation to the economic enterprise should be considered an expense related with the purpose.

In the Financial/Tax Framework Research, 51.2% of civil society organizations stated that transfers made by foundations and associations with status to their economic enterprises in order to recover the losses of such enterprises should be considered as expenses related with the purpose. The finding of the research which indicates that 53.3% of civil society organizations mostly incur loss points to the significance of this issue.

Conclusion

Economic enterprises operated in relation with their purposes by associations and foundations, which are also referred to as the third sector to distinguish them from the public sector (the first sector) and the private sector (the second sector), carry out activities in an area between the public and private sectors. It is obvious that a tax regime that does not take into account this position would make limited contribution to the sustainability of associations and foundations. In the taxation of the economic enterprises of associations and foundations, the tax administration in our country aims to prevent creation of unfair competition against commercial enterprises that are established only to operate in the market economy, which clearly indicates that they do not recognize the said position.

However, looking back at the legislative history documents regarding the Corporate Income Tax Law No. 5422 dated 1949, which marked the beginning of modern income taxation, we observe that the legislator prioritized account keeping and accountability among the reasons for subjecting public economic institutions to corporate income tax. Moreover, certain economic enterprises of associations and foundations always benefited from corporate income tax advantages until 1998. Until today, the state gradually reduced and ended the tax advantages granted to associations and foundations due to both its weaknesses in supervision and budgetary concerns. However, in a recent policy document, the European Union has underlined the potential significant role that can be played by taxation policies in promoting social economy, which includes civil society organizations, and in enabling social economy organizations to operate alongside private sector enterprises.⁵¹

Incomes of economic enterprises constitute a significant resource for the financial sustainability of associations and foundations. The share received by civil society organizations from public resources has been on the decline since the Global Financial Crisis of 2008-2009. Budgets have been further restricted in the aftermath of COVID-19. However, there was an increase in the society's demand for services and meeting their social needs through these organizations. Furthermore, diversification of the types of income held by civil society organizations contributes positively to their financial structure and sustainability by reducing financial volatility, spreading risk and maintaining stability. In the light of all the points explained above, a tax design that encourages the use of income from economic enterprises by associations and foundations should be adopted in Türkiye. In addition, administrative practices that further limit the use of this source due to withholding tax application during their transfer to associations and foundations should be abandoned.

⁵¹ European Commission, "Proposal for a Council Recommendation on Developing Social Economy Framework Conditions", COM(2023) 316 final, Strasbourg, 13.6.2023, p. 21.

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