Current Perspectives in Public Finance

Selçuk İpek / Adnan Gerçek (eds.)

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Preface

This book investigates the different issues of taxation, public expenditures and intervention. It covers the current perspectives in public finance such as taxation of digital economy, delegating the power of taxation, the desperation of tax administration, human rights budgeting, economic growth and tax revenues, minimal state and government expenditures, consumer behaviours, incentives of green energy, and trade wars alike. The book consists of eleven chapters related to the "new public finance" issues mentioned above. The large part of chapters published in this volume was selected among the presented papers in the 33th International Public Finance Conference/Turkey in May, 2018. They also went through a review process before publication.

Biyan and Yılmaz examine the virtual establishment concept by literature review using international developments and comparative law. Also they give proposal for the concretisation of the virtual establishment concept.

Bozdoğanoğlu studies the main features of cryptocurrencies and virtual money, especially the ones that have emerged recently, and explains the differences. In addition, the study examines the difficulties concerning cryptocurrencies, such as anonymity feature of cryptocurrencies, and taxation and regulation discrepancies according to countries.

Çomaklı and Uzun discuss the issue of delegating "the power of taxation", which is possessed to "be able to be a state" in relation with the United States of Europe goal. In this context, the political mechanisms and priorities necessary "to become a united states" are briefly examined.

Erdoğdu and Siverekli investigate the relationship between gross domestic product, a general measure of the growth of the country's economy, and tax revenues, the output of taxation which is the main action of governments' fiscal policies, in the period 2006–2017 in Turkey, using monthly data. The empirical results of the study help the policymakers to make a better assessing of the relationship between tax revenues and gross domestic product to formulate tax policies.

Güngör Göksu analyses the relationship between human rights and state budget and finds out what changes human rights budgeting practices cause on state budgets. Also the study determines the points regarding with analysing human rights budgeting.

Özel Özer, Özer and Mastar Özcan attempt to shed light on how the primary institutions of the public sector keep up with the minimal state objective in Turkey.

In addition, the effort strives to measure and evaluate whether this tendency has been in effect for public expenditures and government budget expenditures for the Turkish case in her historical, political economy development.

Selen evaluates the reflection of the free trade system on public finance understanding. In today's world trade system, the state, especially for conservation purposes, taxation and expenditure initiatives are significantly limited.

Şener makes some psychological analyses about explaining the irrationality problem. Also he evaluates the behaviours of Turkish consumers whose economic choices are dominated by conspicuous consumption motivation.

Tirgil and Yorulmaz investigate the monthly aggregate cigarette sales data before and after the tobacco control policies to declining cigarette consumption in Turkey. They find that cigarette consumption increased until the 2000s, but the cigarette consumption immediately declined after the public smoking regulations in 2008.

Yiğit Şakar studies the financial incentives used to finance energy efficiency in buildings in terms of Turkey and European Union and to make inferences for Turkey. As a result the study determined that the same financing methods have been adopted both in Turkey and European Union, however, Turkey, compared to European Union, has newly begun to implement the tax incentives.

It is our hope that the current volume would be very useful for both academics and policy makers not only in Turkey, but also in many developing and developed countries alike.

Selçuk İpek
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Özgür Biyan[1] and Güneş Yılmaz

A Taxation Problem Caused by Digital Economy: Definition of Virtual Establishment

Abstract: The permanent establishment has been one of the critical issues in international taxation for years. The concept of the permanent establishment has gained a new dimension with the widespread use of the internet. Economic activities in the digital environment have begun to create problems in the tax systems and have caused tax-free areas to appear. In this study, how the virtual establishment concept should be handled is examined by literature review using international developments and comparative law. The proposal for the concretisation of the virtual establishment concept has been given.

Keywords: Digital Economy, Virtual Establishment, Taxation, Tax Law

JEL Codes: K34, H20, F62

1 Introduction

While the extent of the trade carried out through the internet, amongst other economic activities, has reached dramatic levels every year, the disruptions encountered in taxation, insufficient regulations in the face of the transformations and problems manifest themselves intensively both nationally and internationally. The term "workplace/establishment", particularly in the economic activities carried out in the electronic environment, contains some uncertainties as to which country shall be entitled to use the power of taxation, for the reason that traditional definitions remain incapable in terms of scope and comprehension, which in turn undermines the foundations of the principle of fairness in taxation and leads to some non-taxable areas. International aspect and impact of the subject have increased so much so that even the international organisations had to carry out some activities as to how the concept of "workplace" had to be dealt with in the digital activities. Especially, the works that began towards the 2000s continue nonstop. In this context, the European Union took some actions to resolve such problems by itself. On the other hand, although Organisation for Economic Co-operation and Development (OECD) offered some proposals by issuing reports for the member countries, it turns out that the problem persists. Aware of the significance of the subject in question, our study underlines that the

1 Corresponding author.

concept of "workplace" should be redefined in terms of the economic activities carried out in electronic environment, in accordance with the developments in the international arena; it discusses the assessments in line with the approaches of the international organizations as well as the opinions in the doctrine and proposes some solutions. It also addresses the existing situation in the Turkish Tax System and future works.

2 Digital Economy and Its Effect on Tax Law in General

2.1 Digital Economy and General Characteristics

The term "Digital" means "the display" or "displaying the data electronically on a monitor" (www.tdk.gov.tr). In this sense, all of the electronic activities that are performed in the electronic environment through a computer today can be accepted as the digital economy. Therefore, all types of goods and services, offered via the internet as part of economic activity through mobile devices (mobile phone, tablet, etc.), particularly the computers, are included in the scope the digital economy. The digital economy, for which the legal regulations established according to traditional economic activities remain incapable, and which require particular arrangements, are closely related to the taxation that is an important area.

Particularly the development of information and communication reshaped the organisational structures, production techniques, decision-making processes and marketing strategies of the businesses. Further to that, the most significant change is that the virtual businesses have become a part of our daily lives. So, the concepts of virtual businesses, virtual traders, virtual workplace/establishment or in other words, the concepts such as e-business, e-trade, e-workplace have to be redefined, and all applications and legislative works have to be carried out accordingly (Gencer, 2013:21).

Therefore, the first assessment that can be made should be on the concept of "digital activity" and activity must satisfy the following elements to be regarded as a digital activity, according to the OECD (Hongler & Pistone, 2015: 30–31):

(1) Whole enterprise or a vast majority thereof should rely on the trading of digital goods and services.
(2) The goods and services delivered differently from the existing ones, such as the commercialisation, processing and collection of the location-related data, other IT tools, websites, server maintenance or operation should be the physical elements and activities that do not include real/material creation.
(3) Agreements should generally be finalised via the internet or phone remotely.

(4) Payments should primarily be made on credit cards, with online forms or through the electronic payment methods integrated with the connected links.
(5) Websites are assumed to be used only to enter the headquarters of a company; not to be associated with the activities of the physical stores or branches in the countries where the principal company or operating company are located.
(6) A vast majority or all of the profit should correspond to digital goods or services.
(7) The consumer should not consider the physical location and legal/taxation domicile of the vendor nor should it influence the preferences of the consumer.
(8) Performance of digital service or actual usage of digital goods should not require a physical workplace nor should it require the inclusion of physical product, other than the use of a computer, mobile device or other IT tools.

This approach of OECD was criticised in some aspects and claimed to conflict with the principle of impartiality, in particular. As an example, it is not a big deal whether all or the vast majority of an enterprise relies on the trading of digital goods and services. It may rely on digital activity partially or to a certain extent. Its volume, more or less, does not affect the essence of the matter. The same applies primarily to the payment made using a credit card and electronic payment methods. Considering the principles of fairness and impartiality, it was stated that there was no significant justification for a new workplace definition and it also did not contribute to the establishment of a relationship between digital activities and non-digital activities and formation of a new connection. A new definition should cover not only the suppliers of online advertising, e-commerce but also undoubtedly other enterprises. *A threshold must be set* to work out an outcome which is compatible with the principle of impartiality (e.g. giving/offering access to an electronic application, database, online market, storage room or providing advertising services on a website or in an electronic application) and this threshold, regardless of whether the vast majority of the activity is digital or not, should be an assurance and be used equally for everybody (Hongler & Pistone, 2015: 31). It would be fair to say that "setting a threshold", which is outlined in the literature as the most concrete proposal, is highly essential and acceptable. However, it is quite evident that the points, such as the content and level of thresholds need to be addressed and discussed.

It should be noted that the common characteristic of the transactions in the digital economy is the availability of one or more mediators. For example, cloud services consumer may outsource the services that it needs, directly from a cloud

service provider or a cloud service broker. Cloud service mediator serves as a station between the consumer and service provider. While the mediators can combine more than one service request to create a new service, they may also choose to improve the available services and deliver them to their clients (Budak, 2018: 76).

Nevertheless, the transactions performed in digital economy fall into three categories when considered for the parties: Business to Consumer (B2C), Business to Business (B2B), and Consumer to Consumer (C2C). In the digital environment, almost all of the transactions are performed as B2C and B2B.

2.2 The Effect of Digital Economy on Tax Law

There are some essential points where the digital economy disables the generally accepted principles of international tax law. These can be summarised as "elimination of the need for a physical presence", "the date being the principal element of the production" and "the problem of identifying the character of income" (Uslu, 2017a: 151).

Digital economic activities that violate the taxation powers of the countries and even make it impossible for them to use these powers are at the top of the tax world agenda. The solution for some issues, such as the fact that the digital activities can hardly be controlled, the uncertainties in the delivery point for the goods and services, assessment difficulties caused by mobile applications, the difficulties in identifying the taxpayer and responsible person, etc., is still pending both in national and international context.

Furthermore, based on the developments in the digital economy, there is uncertainty in the current legal regulations in determining the subject to be taxed. Such that, since the products considered as tangible assets, such as newspaper, book, magazine, music CD, computer software, film videos, can be sold/purchased or downloaded free of charge into the hard discs in virtual environment, such digital products are now widely assessed as services, particularly in terms of taxation. In other words, the goods do not necessarily have to be delivered physically because the digital products are relocated as virtual and digital data (Kara & Öz, 2016: 35). Moreover, the business models permitted by the digital economy enable the operations to be spilt on a global scale, and business infrastructure can be set outside a particular market country. Multinational companies acquire the capability to do business in a way to reduce both direct and indirect tax burden (Turunç, 2017: 54).

Nevertheless, multinational companies may avoid being taxed in the Market country one way or another, using the infrastructure offered by the

digital economy or they may erode their taxable profits in those countries. Thus, such companies avoid taxable entities. They can do that by making use of the exceptions in the definition of the workplace or through the execution of the agreement outside the market where the agreement was made and only if the local workforce is employed. They minimise the revenue that can be allocated to the assets and risks. Multinational companies may distribute their risks and assets by making intra-group agreements which do not reflect the functions of the operational units. Therefore, the profits of the assets are shared out, based on legal freehold and intra-group deals. Besides, they enjoy the tax discounts excessively. Multinational companies employ hybrid instruments and assets, to that end. Similarly, they can design the interest, copyright/royalty and service fee flow within the group, as a way to enjoy the discounts. They either pay very low or never pay a withholding tax in the source country. For that, they utilise the network of agreements (Turunç, 2017: 55).

In conclusion, based on all of the explanations herein, fundamental issues caused by a digital economy in the tax legislation can be listed as follows and these assessments involve the subjects that will change and lead the future and reality of the tax and taxation:

- Taxation of internet gaming and gambling (Van der Paardt, 2009: 525–531),
- Taxation of real-time online teaching, online advertisement, online remote equipment-controlling, and online database services (Zhu, 2014: 4),
- Whether a Web site or server can be considered a workplace (Pahlsson, 2002: 198–202; Lexner, 2010: 21–36; Gianni, 2014: 1–38),
- Which country/countries to use the power of taxation (Pahlsson, 2002: 203–206),
- Difficulties regarding the identification of the delivery of digital products and VAT (Pahlsson, 2002: 207–209; Bird & Gendron, 1998: 429–442),
- Taxation of cloud information services (Budak, 2017: 301).
- Use of digital assets, the establishment of front companies, abuse of tax agreements, in an attempt to avoid the withholding tax obtained from non-domiciled businesses, due to the payments, such as the interest or copyright/royalty, etc. (Budak, 2018: 63).
- Use of hybrid mismatch arrangements or extensive use of excess deduction mechanisms (Budak, 2018: 65).
- Taxation of the transactions and earned income, concerning the payment services (Gülhan & Turunç, 2015: 167).
- Taxation of the income obtained from the application programs and transactions (Gülhan & Turunç, 2015: 167).

- Taxation of participating network platforms (Facebook, Instagram, Tweeter, etc.) (Gülhan & Turunç, 2015: 167).
- Taxation of Online Domain and Online Domain Name Hosting Services (Ertaş, 2017: 133).
- Taxation of Freelance services (software, search engine optimisation (SEO), graphic design and translation) (Ertaş, 2017: 134).

Although these are the issues identified, which need a comprehensive solution, the top title points out that the doctrine focuses primarily on three regimes concerning the taxation of digital economy (Gülhan & Turunç, 2015: 168):

a) *Residence-based regime*: Although it means as close as generally accepted workplace definition, it does not require a physical presence and is based on an accepted system which is remotely manageable. An international consensus seems to be imperative.
b) *Source-based regime*: If any income is earned through the digital activities from a country market, it is accepted that the said country should be paid tax because such income is earned, thanks to the structure, sources and opportunities/facilities of the said country.
c) *Mixed regime*: It is based on the collective use of residence-basis and source basis.

As a result, to make a definition in a more general sense, digital economic activities result in uncertainty in the following matters regarding taxation:

- Identification of taxpayer (who will declare and pay tax)
- Identification of the type of the income (commercial, self-employment, intangible right, etc.)
- Identification of the location where the income is earned (the place of the event generating the tax, workplace)
- Identification of the amount of the earned income and taxable income (tax assessment)
- Which tax regime is to be implemented (direct taxation, withholding at source, etc.)
- How to use the tax collected on the expenses.

3 Impediment in the Use of Power of Taxation: Workplace Concept

The workplace, which constitutes a basis for taxation as a place (location), is defined as nexus which enables the commercial income to be connected to the

power of taxation of the source country in which such income is earned (Yaltı Soydan, 1995: 131). One of the nexus rules in the use of the power of taxation, the subject of "workplace" is essential ground on which the tax office can raise the tax from corporate taxpayers and commercial taxpayers. Those who have a business within the political boundaries of a country shall be subject to the taxation regime of that country. The first point to be considered in applying the principle of residence, which is a fundamental principle in taxation, is whether the person/organisation has a workplace.

One of the critical issues created by the digital economy is that it causes the definition of traditional "workplace" concept to lose its meaning today, regarding tax legislation. Such that, traditional workplace forms a basis, within the context of domestic law, so that the bond between the government which is entitled to the power of taxation and the taxable activity is materialised and embodied. Above all, the concept of "workplace" had to be redefined because the cloud information systems began to be used widely as the number of the applications, which deliver services through the mobile applications or websites but the activities of which affect all countries has increased. Such that, the workplace concept at international level is defined traditionally and linked to the tax legislation mainly based on "permanent establishment". In this context, according to the explicit rule of OECD Model Convention, unless a company in a country carries out activity in another country through the means of a permanent establishment in another country, no direct tax is applied on its commercial profit based on net income in the other country (Hoffart, 2007: 106). Such a definition is indeed not suitable to understand today's digital economic activities and to implement the rules of traditional tax legislation. That is, the rules in the current traditional tax legislation lead to some problems in applying both the tax collected on Income and the consumption taxes like a VAT.

On the other hand, DTT (Double-Tax Treaty) regulations with respect to the workplace concept still underline a permanent and physical location to create a "workplace" and to accept the existence of such an establishment and therefore the countries failed to come up with a structure upon which they agree (For further information, see Kara & Öz, 2016:32). For this very reason, discussions and works continue concerning the content of the workplace concept, especially in OECD reports and in double taxation treaties and the related domestic law regulations began to address comprehensively the idea what should be understood in the workplace concept.

The discussion, experienced in practice on the concepts of "workplace" which are thought traditionally and has taken its place in the regulations as well as "e-business" that we face at the level of e-commerce, continues on these

two topics over the past few years. The basic immediate question here is the point whether we can match up the scope of "e-business" with the content of "workplace" in the traditional sense, by using the basis of "web pages" and/or "web servers". Put it differently, can the "web pages" and/or "web servers" be deemed as a "permanent establishment" or "permanent agent"? (Gencer, 2013: 22).

3.1 OECD's Approach to the Concept of Workplace

3.1.1 OECD's Overall Approach since the 1990s to Present

Carrying out some works to tax the electronic commerce since the second half of the 1990s, OECD began to work on the "taxation of the digital economy", with the development of business models performed through the internet. In 1998, initial steps taken in the Ottawa Meeting began to concrete as OECD BEPS (Base Erosion and Profit Shifting) Project was put into practice in 2013. In the end, more than 70 ministers and high-level delegates representing 70 countries, including Turkey, signed the Multilateral Convention to Implement Tax Treaty-Related Measures to Prevent Base Erosion and Profit Shifting – "Multilateral Instrument" or "MLI" on June 07, 2017. Thanks to MLI (Multi-Level Instrument), the countries will be able to transfer the outcomes and measures outlined in OECD/G20 BEPS project into international tax treaties, international tax conventions and close up the gaps (Yıldırım, 2017: 54). It will prove beneficial to scrutinise the steps taken by OECD in the taxation of the digital economy from 1990 to present, for the essence of the subject.

In the meeting held by OECD between 7 – 9 October 1998 in Ottawa, Canada, it was agreed that policies had to be produced based on the principles of "*impartiality, productivity, precision and simplicity, effectivity and fairness and flexibility*" (Gülhan & Turunç, 2015: 169) and the following outcomes came forward with respect to the electronic commerce (Cangir, 2002: 24).

- New technologies, underpinning the electronic commerce as well, offer the tax offices new significant opportunities to improve and develop the services they offer the taxpayers. OECD member countries are determined to utilise these opportunities to the full extent.
- Taxation principles taken as a basis by the governments in the taxation of traditional commerce must also be referred to in the taxation of electronic commerce. Existing tax legislation is sufficient, in order to put these principles into practice, considering the development stage of technology and commerce. The new regulations to be set forth should be introduced in an attempt

to help implement the current taxational principles and not to aim at different taxation for electronic commerce transactions.
– The following three aspects should be noted in implementing the tax regulations made in the national level in order for the current tax principles to be implemented in the electronic commerce as well as the international tax principles, in the electronic commerce: "*Maintaining the financial autonomy of the countries; ensuring that the tax income collected on electronic commerce is shared out equally amongst the related countries; preventing unnecessary taxation (abuse) by means of double taxation*".

Also, it was suggested in the mentioned meeting that VAT shall be accrued in "the place of consumption" and digital products cannot be regarded as physical goods regarding customs duties and VAT. Therefore, the transactions carried out as part of electronic commerce contradicted the place of consumption. Besides, the rules and principles of assessment and realisation for the value-added tax on electronic trade have not yet been set forth thoroughly (Ertaş, 2017:136). Hence, four different solution approaches came into existence concerning the taxation of electronic commerce before the efforts were initiated towards the action plans (Alptürk, 2005: 313):

– to take the electronic environment sort of "free trade zone" and not to impose any tax,
– to impose a tax using "byte" taxation which is "an electronic sales tax", based on the taxation of the volume of the transferred data used during the sale, which is measured in "byte", regardless of the nature of the electronic transactions.
– to impose the tax under the rules available in the current legislation,
– to impose the tax according to the instructions to be outlined in the local tax legislation and double-tax treaties.

Although the first decade of the millennium went by within the frame of these opinions, OECD began to take some firm steps in 2013 using Base Erosion and Profit Shifting (BEPS) Action Plan, to clarify the concept of the electronic workplace. The leaders of G20 countries came together and agreed upon BEPS Action Plan consisting of 15 actions in order to prevent foreign tax losses, and they reached a consensus to review their legislation by this action plan (Payne & Raiborn, 2018: 472). Moreover, the first action of the mentioned action plan was determined as the "Taxation of Digital Economy" No. 1 (Gülhan & Turunç, 2015: 171). In this context, BEPS Action plan mainly included the proposals regarding the direct taxes, in the taxation of digital economy (Uslu, 2017b: 151–152). OECD favoured the idea that tax should be imposed in the place of

consumption, concerning the transactions carried out "business to business" and "business to consumer" (Ertaş, 2017: 137). These proposals are listed as follows: "*Withholding at source*", *"digital equalisation levy"*, *"digital presence-based establishment"*.

The first action clause of BEPS Action Plan suggests that it is required to determine whether the digital economy poses a threat for the existing international tax rules, by taking both indirect and direct taxation practices into account, with an integrated approach and the alternatives dealing with these problems should be developed. Some of the points to be discussed within the scope of article #1 of the Action Plan are as follows (Turunç, 2017: 51):

a) the capacity of the companies to possess a digital existence in another country's economy, without having to pay any tax, for the reason that a sufficient connection cannot be established between the existing international rules,
b) determining the characteristics of the income earned through the new business models,
c) how to determine the VAT or goods and services tax that are caused by the use of the relevant source rule and cross-border circulation of digital goods and services.

Moreover, while determining the exceptions concerning the workplace definition set out in article #5 of the OECD Model Tax Convention, the activities covered by such exceptions were assessed as "***preparatory or auxiliary***". However, some dramatic changes happened in the operational applications of multinational companies since the beginning of these exceptions. In line with the changing conditions, the activities which were previously thought to be preparatory or auxiliary, correspond to the basic activity areas today. Intending to tax the profits which are acquired through the activities carried out in a country, it is recommended that each of the exceptions contained in the article #5 of the Model Convention is changed in order to limit those exceptions with "preparatory or auxiliary" activities (Turunç, 2017: 56).

3.1.2 OECD's Approach to the Workplace (Establishment) Concept and Changes

3.1.2.1 General Description

It is seen that the OECD Model Convention mentions the definition of "permanent establishment" in article #5/1. So, a permanent establishment means "*a permanent location in which a business is carried out wholly or partially*" (OECD,

2017:12). Likewise, the OECD Model Convention stipulates that a permanent establishment is required to include the following features (art. 5/2) notably:

a) place of management;
b) a branch;
c) an office;
d) a factory;
e) a workshop/plant and
f) using different methods for mining, drilling oil, gas well, extracting stones, natural resources from the quarry, etc.

Also, the 2017 draft of the Convention underlines ***what a permanent establishment cannot contain***, as well. Hence (OECD, 2017: art. 5/4):

a) the facilities must be used to store, display or deliver the goods and items of the establishment, only;
b) the goods and items of the establishment should be stocked only for storage, display or delivery;
c) to maintain the goods or item stocks of the establishment so that they can be processed by another organisation, only;
d) to maintain a fixed/permanent location of the establishment in order to sell goods and commodities or collect data, only;
e) to maintain permanent location regarding the business, to keep any other activity of a preparatory or auxiliary character, only for the establishment;
f) to maintain a permanent location only, for any combination of the business.

The element of "Permanent location" includes the elements of permanency and continuity, in a geographical sense. Concerning a business, a location, which constitutes a whole commercially and geographically, can be regarded as an establishment. A major element concerning "permanent establishment" is the element of continuity. Therefore, a permanent location regarding the business can only be considered an establishment if it is used on a continuous basis, rather than temporary. It is open to comment under what circumstances a business can be considered to be used on a continuous basis. Nevertheless, it is still possible to recognise the existence of an establishment if the business is carried on at the same location for a specified period (six months) or at shorter intervals but in more than one occasions. Also, in case a permanent location, which was initially secured for long-term commercial activity, abandoned for a short time due to an unpredictable reason, it should be accepted that the establishment has been formed. The main point here is the purpose (Cangir, 2000a: 57) and intention.

Pursuant to the article #5/5 of the Model Convention, if a person other than an agent operating independently is entitled to act on behalf of the enterprise in another contracting country and to execute a contract on behalf of the enterprise and also if such person regularly uses the power of executing a contract, then such enterprise will be accepted to own a permanent establishment in such other contracting country unless he/she carries out any activity which will not necessitate the formation of a permanent establishment, as specified in article # 5/4. Furthermore, if an enterprise carries on its commercial activities in another contracting country, through the means of an independent broker that performs as part of its own business, general commission agent or similar agent, a permanent establishment will not necessarily be formed in such another contracting country (Organ & Kara, 2017: 5). It is important whether or not the contracts supplemented by the dependent agency are executed on behalf of the enterprise. However, if the supplemented contract is binding the enterprise – even though it is not made on behalf of the enterprises, the agency executing the contract will be accepted as having an establishment (Işık, 2014: 117). At this critical point, one of the proposal that could be introduced into the definition of establishment (workplace) in the context of BEPS Action Plan No #7 is the point by which the locations used for purposes such as, "storage, exhibition, goods transfer centre, data collection centre, etc.", that are considered to be auxiliary and preparatory activities yet do not constitute an establishment, in the context of the Model Convention, can, from now on, be accepted as establishments by looking at the characteristic of the commercial activity (Uslu, 2017b: 160).

In general terms, it should be checked whether the activity being carried out at a permanent establishment constitute a ***substantial and significant part*** of the activity concerning the entire business. If the activity of an establishment is a separate, distinctive activity which is destined for a single purpose within the general line of business of the establishment, the preparatory and auxiliary feature cannot be mentioned (Yaltı Soydan, 1995: 134). Based on the works carried out so far within the scope of BEPS Action Plan No #1, while a permanent location cannot be regarded as a "permanent establishment" only if it is not preparatory and auxiliary, other permanent locations, which have a significant number of employees and attach great importance to quick delivery to their customers on time and on-site, will be accepted as a permanent establishment and subject to taxation for the seller (for more information, see Kara & Öz, 2016: 33).

In the guidelines published for the Action No #1 of BEPS Action Plan, the following proposals were suggested to the member countries concerning the digital workplace/business applications (OECD, 2014a: 43):

- to impose a minimum tax in the country of origin by regulating the deductions on the paying side,
- to impose no or low tax on the source,
- to impose less tax or impose no tax on the income, which is not continuous, using intra-group regulations (to cover the income that can be earned through law tax legislation, preferential regimes or hybrid mismatch),
- not to impose any tax for low income at the level of parent/principal company.

3.1.2.2. Website and Server Arguments

Considering the comments on OECD Model Convention, it was stated that the websites with respect to electronic commerce cannot always be accepted as an establishment unless they are also equipped with machinery, equipment and items regarding the fixtures and therefore the websites, which consist of electronic data or software only, cannot be accepted as an establishment, on their own (OECD, 2017: 117 § 123). This comment does not make it possible to accept the websites as an establishment unconditionally (Hongler & Pistone, 2015: 12). On the contrary, since the server, on which the website is installed and which allows access to the site, is an equipment with physical presence, the location where the server in relation with the website on which electronic trade is performed, raises the issue whether or not the server can be considered as an establishment provided that the server has remained in such location for a specified period (long enough to cause this existence to be considered permanent/continuous) (Batun, 2014: 70).

According to the interpretation on the article #5 of OECD Model Convention, concerning the concept of a permanent establishment in the digital economy, there were some arguments on whether or not the mere use of computer equipment in the electronic commerce transactions taking place in a country could constitute an establishment. There must be a distinction between the computer equipment that can be installed in a way to constitute an establishment in a location under certain circumstances even though such equipment can constitute an establishment in a country in a territory where automatic equipment is operated by an enterprise and the data/software used or stored by such equipment. As an example, a website, which is the combination of software and digital data, does not constitute a presence, on its own. Therefore, it does not have a location to constitute "a place for the business"; because, in the context of the software and data which make up of such website, there is not "a plant like the buildings or machinery or equipment in certain conditions" (Budak, 2018: 113–114).

The summary of the final report as regards the Action 7 following the update in 2017 set out two amendments in general (Yıldırım, 2017: 54):

1) If now an affiliated company/person plays a key/principal role in the process in a way to lead to the outcome that the contracts are made and finalised in the country where they operate and such contracts are approved by the company (the company for which the contracts primarily are made) without being modified, such company/person playing a vital role in the contracting process shall be considered to have formed an "establishment" in the country they are based. (Except for the businesses regarding the preparatory/auxiliary operations of such companies/persons as specified in paragraph #4 of article #5 in the model convention and the operations of such companies/persons as independent agents).

2) The second basic amendment is about the preparatory/auxiliary operations as specified in paragraph #4 of article #5 in the model convention and the cases that exclude such operations to constitute an establishment. This amendment was intended to split the operations and businesses, which are a meaningful whole, into smaller operations by dividing them into segments in various shapes, in an attempt to prevent the inhibition of workplace formation by ensuring that each operation is rendered preparatory/auxiliary. If the persons/companies that are closely associated with each other carry out operations in different locations, which supplement each other and constitute a significant whole in total and the total of such operations are no longer preparatory/auxiliary, then it will be possible to say that an "establishment" was formed in the locations where such operations are carried out.

However, the enterprise that carries out commercial activity by operating a website can vary from the enterprise that operates the server on which such website is installed and through which it delivers services. Therefore, the distinction between "website" and "server" is important in that respect, as well. What is mostly encountered in practice is that the website on which an enterprise carries out commercial operations is installed on the server of "an internet service provider". Even though in this example, a fee is paid to the internet service provider by the enterprise operating the website, based on the disc space required to store the software and data on the server, it is not possible to agree that the server will be at the disposal of the enterprise operating the website. Here, the services are offered for a fee by an internet service provider. Therefore, in this case, we cannot say that the enterprise operating the website owns the establishment (Batun, 2014: 71).

Another point being discussed in the context of the fact that a server is required to be considered an establishment is an issue of how the revenue to be attributed to the establishment (server) will be determined. Some commentators claim that even though a server can be accepted as an establishment, they argue that a server should not be deemed as an establishment for that reason alone, by underlining the

problems to be encountered in distributing the revenue. This approach emphasises the diversity of the business functions as part of the commercial activity in the electronic commerce environment and the difficulties in the implementation of the article #7 of the Model Convention. Nevertheless, it seems quite difficult to associate this approach with the underlying rationale of the Model Convention. Because under the provision of the first clause of the article #7 in the Model Convention, if an establishment exists, some income should be allocated to that establishment. The rationale here is to determine the "existence of an establishment" first and then "the income" to be allocated here too. However, this rationale works the other way around in the approach arguing the idea that a server should not be considered an establishment due to practical difficulties (Cangir, 2000a: 59).

Both this situation and the fact that the website publishers that rent the servers have no control and right over the technical equipment and assets on which their websites are installed, other than receiving a rental service, make it impossible to determine an establishment and/or a representative by using the concept of "web pages" and/or "web servers" (Gençer, 2013: 22).

Based on what's concluded here, it will not be a fair approach to accept each web page or web server as an "establishment". The decisions taken in Ottawa Meetings favours the idea that a separate taxation regime would not be required concerning the taxation of electronic commerce. However, the idea that this approach should be abandoned is more prevalent today, based on both the current situation today and the approach of OECD in the last few years. Such that, traditional taxation principles and definitions are open to abuse and can create an unfair competition environment, as they remain incapable of comprehending the electronic trade. On the other hand, the fact that a website or web server should be accepted as an establishment in any case and condition will lead us to a unifactorial and accordingly to uniform taxation. For instance, a matter to be taxed as an element of "agricultural income", without taking the existing taxation rules into account, needs to be taken into account and taxed as a "commercial income", with the establishment approach that is attributed to the websites. With regards to the element to be taxed, the distinctions set out in the current legal regulations will eventually be taxed as a "commercial income", by rendering them down to a single revenue item. Hence, despite what's been achieved so far since 1998, it is evident that more accurate assessments should be made in defining the digital workplace and previous assessments are still insufficient.

3.1.2.2. Threshold Proposals

In the report regarding the Action No #1, an international agreement was reached on the proposals in the collection of VAT and Sales Tax, which entitle

the country where the end user or the customer is located, to power of taxation, in the collection of VAT of the products submitted from the cross-border "business to consumer" (B2C). Concerning other taxation challenges, the uncertainty in the fact of the "location of the economic activities" and "the location where the value is created" continues to cause a disagreement on the subject of taxation (Kahraman, 2017: 1).

The Final Report #7 of BEPS on "Preventing the Artificial Avoidance of Permanent Establishment Status" was intended to offer some changes in the text of OECD Model Convention, with regards to the formation of the establishment, which are listed as follows (Kahraman, 2017: 2):

- Expanding the dependent agent test,
- Limiting the independent agent exemption,
- Limiting the business exemptions concerning the use of enterprise facilities for storage, display or delivery of the goods (including an anti-fragmentation test to prevent the activities from being split into separate enterprises),
- Preventing the abuse of the business rule dependent on 12-month construction site.

"Action 15 – Multilateral Convention" was established to put the changes regarding the Action #7 of BEPS into practice in the short term. So, "Multilateral Convention to Implement BEPS Actions Regarding the Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting" which is the Action #15 was executed on 7 June 2017 at a signing ceremony joined by the representatives of more than 70 countries. Moreover, Turkey was one of the countries to sign the Convention.

It was emphasised that the term "workplace" mentioned in the Action Plan #7 of BEPS had to be redefined and mainly it was suggested that e-commerce income should be shared uniformly between the country of residence and the country of origin and also it was expressed that it would be appropriate to make a distinction between the delivery of the physical goods and the digital activities (Hongler & Pistone, 2015: 24). In this sense, it can be appropriate to make a definition by considering the concrete proposals and elements, regarding taxation (Hongler & Pistone, 2015: 25):

- Electronic application, database, online selling domains, storages of the residents of the other contracting country, the areas reserved for advertising on a website or application,
- User threshold, the quantity of the people using the electronic application or website (e.g. more than 1.000 users, data usage in a month),
- Certain time threshold (e.g. observation regarding the violation of the user threshold in 12 month period),

- The amount of the income earned (EUR, USD, GBP, CNY, CHF, etc.) (mainly, small business to avoid facing a heavy tax burden),
- The terms such as electronic application, access, database, online activity area, storage, advertising services, website, monthly user period, resident, total income and service must be redefined.

Even though the OECD Report (Addressing the Tax Challenges of the Digital Economy) did not address a particular figure (threshold) (article 5), it mentioned that "digital sales, number of contracts, number of users and consumption level" should be emphasised. Moreover, the report put forth some solutions while it underlined that double taxation should be avoided, as the primary objective. Also, it was emphasised that the companies sustaining any loss during the use of the power of taxation have to be taken into account, as well and mainly it would be appropriate to take this situation into account when taxing the country of origin. (Hongler & Pistone, 2015: 26–27).

Accordingly, it was suggested that if a certain percentage of the total sales of a company based in the country A is made up of the sales carried out in the country B, the country B should assume that such country is doing business in the country B, as well (as if it has a workplace) (OECD, 2014b: 7). Furthermore, if a company, which carries out business in a country but does not have a physical workplace (nexus) and yet does business entirely through the internet, offers its services via a website in the local language of that country, uses the banking and finance system of that country or carries on its business by making use of the suppliers in that country, then it must be considered to carry out business in that country even if it does not have any physical establishment and therefore should be taxed by the country of origin (OECD, 2014b: 41).

It was not deemed appropriate to implement a separate tax system or a differential taxation regime for the digital economy. Instead, it was recommended that some arrangements be made to promote the digital economy. OECD report also includes some possibilities, such as "partial sharing, profit methods, withholding tax in digital transactions and equalisation tax" (Budak, 2018: 134).

Moreover, lastly, in the meeting held by the Ministers of Finance of G20 in Buenos Aires between 19 and 20 March 2018, Tax Challenges Arising from Digitalization – Interim Report regarding the BEPS Action Plan #1 was issued, and it was announced that they would work towards a consensus-based solution by 2020. The report sets out the applications of the countries in the short term. However, it is emphasised that the primary objective in OECD is to pave the way to proceed towards "a long-term multilateral solution" in the next stage (Kahraman, 2017: 2).

3.2 European Union's Approach to Workplace/Establishment

A proposal called "**target country-based cash flow tax**" was made in the studies conducted by a Group of Specialist on Taxation of Digital Economy in European Commission, within the scope of EU. As part of the mentioned proposal, VAT is supposed to be calculated based on the cash flow, as a principle. Likewise, "Common Consolidated Corporate Tax Basis" was suggested concerning the Corporate Tax. In this way, the companies earning income from several countries within the union will be taxed based on a single regime (Budak, 2018: 136–137).

European Union Commission for Taxation of Digital Economy is in the opinion that it will not be possible to impose a tax on a seller (vendor) who does not mainly reside in a country, does not have a permanent establishment, but markets physical or digital product via online selling only, by relying on the rules of a permanent establishment (Hongler & Pistone, 2015: 13–14).

As in the example of Rubik Agreements signed between Switzerland, United Kingdom and Austria, the power of collection can be shared among the countries as a significant step towards the distribution of the tax revenue. One or more countries can collect on behalf of others and share the tax revenue. Alternatively, they can let a single country to impose the tax, using a system called "one-stop shop" as in the European Union and agree on the sharing of the tax collected, as a solution (Hongler & Pistone, 2015: 37).

In EU's universal VAT system, it was agreed that indirect tax, just like the VAT in cross-border trade, is supposed to be collected in the place where the service is consumed. The international acknowledgements regarding the country from which the VAT arises are seen as similar with the article #6 of the VAT Law No. 3065. Even though the European Union points out the place of consumption for VAT assessment, it introduced a system called MOSS (Mini-One-Stop-Shop), by taking advantage of being a union. MOSS is a VAT system designed by the European Union. Based on this system, the sellers can register to MOSS in any one of the EU member countries and submit VAT returns electronically in three-month periods. So, the collected VAT is transferred to MOSS, which transfers such amounts electronically to the related countries.

On the other hand, the sellers who are not a member of MOSS submit their VAT returns and pay directly to the related country in three-month periods. However, as it is seen, the system in question runs on voluntary registration. Therefore, it may not be seen as an efficient solution in preventing the assessment losses (Ertaş, 2017: 137).

The regulation of EU, called "digital taxation package" which allows imposing a tax without having "a physical presence/nexus", is one of the significant and

final steps regarding the taxation of digital activities (Kahraman, 2017:4). The arrangement, which aims at ensuring that online businesses contribute to the same taxation regime as the companies associated with a traditional physical establishment, contains a recommendation to change Double Tax Treaties with the third countries. The practice, called "Digital services tax", allows the member countries to impose a tax on the income earned in their soils, without having "a physical connection/nexus".

Specific digital services, including the provision of advertising area, availability of market areas and transmission of collected user data, while offering digital content or payment services, were introduced into the subject of Digital Services Tax. Taxpayers are the organisations with an annual global revenue above €750 million and annual revenue above €50 million stemming from the digital services in EU (Kahraman, 2018: 3).

In this context, as the criteria to be considered in recognising a business operating in a country as a digital establishment even though it does not have a physical presence in that country, it was proposed that such business is to be associated with the income which will require the "significant digital presence" to be acknowledged, user and agreement thresholds. Therefore, a company, if it possesses any of the following criteria, will be considered to have a "significant economic digital presence" in a Member Country:

- if it exceeds the threshold of €7 million revenue in a fiscal year, from the digital services in a Member Country (e.g. earning income from ad placement according to user data),
- if more than 100.000 users had access to the digital services in a fiscal year in a Member Country (e.g. earning income from the services giving the users access in the shared economy and online markets),
- if over 3000 labour contracts are executed in a fiscal year for the digital services between the company and the business users (e.g. income earned from broadcast streaming services delivered to its subscribers).

"Digital Services Tax", defined temporarily by EU Commission, is projected to be implemented as from January 1st, 2020 and collected by 3% based on gross income. However, it has to be remembered that they will also need the approval of 28 member parliaments in order for them to be implemented. In case a tax is imposed by 3% under the proposal of the Commission, this will mean an opportunity for the member countries to earn approximately €5 billion annually. When applied to the EU, this single-rate tax could promote "tax exchange" and "avoidance in tax distortion" in a single market. If the bill becomes a law, the technology giants such as Google, Amazon, etc. will have to pay 3% of their

revenue as a tax in the country where the activity is carried on. The fact that the tax will be paid in the country where the activity is executed could undoubtedly affect negatively the tax revenue of the countries like Ireland in which such companies are based (Kahraman, 2018, s.4).

3.3 The Situation in Turkish Tax Law

Based on TSI data, the percentage of internet users shopping online in Turkey appears to be 24.9 % as of April/2017. According to the same study, those who purchase goods/services via the net purchase services apart from physical products are: 2.7 % e-learning, 24.1 % travelling services, 13.6 % sportive and cultural activities, 14.5 % holiday and accommodation. The data in question indicate that a considerable amount of internet users in Turkey tend to buy online. The data obtained in the recent study is estimated to cover both domestic and overseas online service purchases (Ertaş, 2017: 133).

Before we move on to define the concept of "workplace/establishment" in Turkish Law, it will be appropriate to make a quick mention of the legal arrangements made concerning the digital economy. The initial step taken to control the activities of the digital economy began with the Electronic Signature Law No. 5070 (Official Gazette, 23.01.2004/25355). Then, the Law on Regulation of Publications on the Internet and Combating Crimes Committed Using Such Publications No. 5661 (Official Gazette, 23.05.2007/26530), Consumer Protection Law no. 6502 (Official Gazette, 28.11.2013/28835), Law on Regulation of Electronic Commerce no. 6563 (Official Gazette, 05.11.2014/29166), Privacy Act no. 6698 (Official Gazette, 07.04.2016/29677) entered into force, and some arrangements were introduced towards the activities carried out in the digital environment. Besides, the Electronic Notification application was launched.

3.3.1 Today: Current Regulations

Natural persons who are under a full obligation (as taxpayers) under the Income Tax Law are subjected to taxation based on the profits and income they earn both at home and abroad (ITL art. 3). On the other hand, those with limited liability (as taxpayers) are bound up with special arrangements. Especially, regarding commercial income, the income earner is required to have an establishment or keep a permanent representative in Turkey and earn its income at such locations or through such representatives.

Under the Corporate Tax Law, of the taxpayers listed in the law, only those whose registered or head offices are based in Turkey are required to pay tax as fully obligated taxpayers based on the total income they earn both in and outside

Turkey. Those who have neither a registered nor a head office in Turkey are taxed based only on their income in Turkey. Furthermore, the commercial income earned by foreign organisations which have an establishment or keep a permanent representative in Turkey, from the transactions carried out at such locations or through such representatives.

Moreover, yet, it is seen that the concept "establishment" is discussed as a nexus, as a headline in taxation regarding the national law.

It is observed that the workplace in our legislation is defined and regulated directly in Tax Procedure Law. Pursuant thereto, a workplace is defined as follows "*a workplace in a commercial, industrial or professional activity is a location allocated for the execution of any commercial, industrial or professional activity or used in such activities, such a store/shop, office, bureau, surgery, workshop/plant, branch, warehouse, hotel, café, leisure and sports centres, farm fields, orchards, garden, farm, livestock plants, fisheries and dive-in fishing spots, mines, quarries, construction sites, ferry buffets/snack bars, etc.*". As can be seen, a suitable arrangement dealing with the digital workplace is in place in the domestic law.

The Cabinet was authorised in Turkey by adding a clause into the article #9 of the Law No. 6745, dated 20 August 2016 as well as into the article #11 of Tax Procedure Law. Upon this regulation, the Cabinet was authorised to impose tax withholding on those who are a party to or mediator in the taxable transactions and to set different rates of withholding/deduction, – but only between the lower and upper limits set out in the tax legislations – as regards the taxable transactions, in respect of business groups, business types, sectors and commodity groups, regardless of whether or not the payees are taxpayers, whether the payer or the mediator in the payment is obliged to withhold tax as per the tax law, whether the payment is destined to cover the purchase of goods or services, whether it is carried out in electronic environment and whether the payee used such amount to get a discount, in determining the basis of tax assessment.

Upon the authorisation in question, those who are "party to" or "mediator in" the transactions, "business to business", "business to end consumer", "consumer to consumer", "thing to thing" and "server to server" as part of internet of things, can be burdened with "tax obligation", but only within the lower and upper limits set out in income tax or corporate tax laws (Kahraman, 2017: 4).

3.3.2 The Situation in Draft Tax Procedure Law

The use of the concept, "establishment in the electronic environment", in TPL draft, which is likely to become law soon, appears as an outcome of the studies carried out in the international arena, in order to tax the digital economy more

effectively. The article #130 of the draft law states that in case the internet, extranet, intranet or a similar telecommunication media or tool is allocated to a commercial, industrial or professional activity or used in such activities, a workplace will be formed in an electronic environment. Nevertheless, the electronic environment was also added to the extent of "workplace", as mentioned in the article #129 of the Draft. However, electronic environments like a website are merely tools (Ertaş 2017: 137).

According to the article #129 of the TPL Draft, "a workplace/establishment" is "*a location allocated for the execution of any commercial, industrial or professional activity or used in such activities, such a store/shop, office, bureau, surgery, manufacturing plant, branch, sales point, workshop, warehouse, laboratory, showroom and exhibition hall, education/training and course locations, home office, auction hall/room, hotel, café, leisure and sports centres, farm fields, orchards, garden, farm, livestock plants, fisheries and dive-in fishing spots, salt works, mines, quarries, construction sites, cargo and passenger transport vehicles, ferry buffets/snack bars,* ***mobile devices, electronic media or fields,*** *etc.*"

According to the article #139 of the TPL Draft, "a workplace/establishment in electronic environment" is "(1) *In case of internet, extranet, intranet or a similar telecommunication media or tool is allocated to a commercial, industrial or professional activity or used in such activities; a workplace will be formed in the electronic environment. (2) Ministry of Finance is authorised to determine the matters regarding the scope of the workplaces formed in an electronic environment and the fulfilment of the duties concerning the tax obligation; hold the mediators in supplying the goods and services by means of the workplaces formed in electronic environment or in paying the price of such goods and services as well as the buyers of the goods and services, severally responsible for the payment of the related taxes and to determine the rules and principles regarding the application.*"

The regulations for the current establishment (TPL 156) do not cover or embrace the "digital activities." TPL Draft Law acknowledges "a location allocated for the execution of any commercial, industrial or professional activity or used in such activities, such as mobile device, electronic media or fields" as the workplace/establishment. The terms "allocation" and "usage", which are included in the regulations, need clarification. Moreover, the authority granted to the Ministry of Finance is controversial regarding the Constitution.

3.4 Consequences of the Lack of Definition of Establishment

Three significant questions emphasised by OECD BEPS Action Plans need to be answered correctly:

1. Where is the economic-commercial activity carried out?
2. Where is the economic value created?
3. Where (or what) do the taxable income stem from, arising from the created value?

When the permanent establishment was defined and theoretically developed, there was no such term as the digital economy, and neither the computers nor the digital world was a part of the economy (Hongler & Pistone, 2015: 21). The traditional concept of "establishment" has become more restrictive for the source countries over time and almost formed a "cage" for them, which in turn paved the way for adopting an international tax planning (Hongler & Pistone, 2015: 10).

Since the digitalised activities allow the companies to perform a commercial activity without them showing a physical presence, they rule out the requirement of physical presence – which is available in the local regulations of that countries – to tax the company profits.

The person or organisation trading via the net can get in touch with the customers anytime and anywhere in the world. In traditional taxation systems, the domicile of the vendor is highly relevant in that a connection can be established with the taxable event and the tax can be assessed. Whereas, the digital activities do not require a nexus (a permanent workplace) or a head office to manage the business. This is because, what is meant by the domicile, is, in fact, the entire world (Alptürk, 2005: 317). Therefore, the fact that the definition of traditional establishment is associated with a permanent and physical location results in the failure to tax the digital economic activities.

The first step to collect tax on internet sales is to establish a collection and payment mechanism, to that end. It is still unclear whether it is required to simplify the sales tax during this formation or to provide the suppliers or credit card companies with sophisticated software. It can also obstruct the development of the sector unless it is easy and sustainable (Alptürk, 2005: 315).

Since the arrangements within the scope of OECD Model Convention seek to produce a solution based on the fact that a place has to be permanent, it fails to find a practical solution for the digital establishments introduced by the digital economy. For instance, it is still unclear whether or not a website will be considered an establishment or what type of taxation will be adopted towards the income earned through the applications operated via mobile devices (Hongler & Pistone, 2015: 2).

Direct taxes have some problems, too. The consequence caused by the lack of the definition of the workplace, what the information transmitted in a virtual

environment is used for (trade-in, paid, free, etc.), failing to identify the nature of the income are some of the major problems (Budak, 2018: 80–81).

- Server and website owned by separate persons,
- Can a server alone make an establishment on its own?
- Can we say that the business of an establishment is operated entirely or partially via the server?

3.5 Opinions to Redefine the Establishment

The fact that multinational companies can get around the concept of "establishment" included in the international regulations and the local codes of law in the countries they do business, due to the complicated company structures and business models (Uslu, 2017b: 160), requires the definition of "establishment" be restructured. The fact that the definition of establishment is made accurately causes the country, where the establishment is based, to be subjected to taxation, due to the income to be attributed to such an establishment. Therefore, the broader the definition of establishment, the higher the possibility of taxing the country where it is located (Yaltı Soydan, 1995: 131). While the OECD Model has a narrow-scoped definition for Establishment, UN Model has a broader perspective (Işık, 2014: 109). In UN Model, expansionary arrangements made about construction sites, acknowledging the places and stocks – which are kept in order to "deliver" the goods and commodities left outside the establishment – as an establishment (e.g. warehouse), regulations related to insurance operations, distinctions related to the subsidiary companies which do stocking for continuous delivery on behalf of parent companies, draw attention as some of the points that expand the power of taxation of the source country (Yaltı Soydan, 1995: 138). The necessity to bring a new definition about the term "establishment" enables the country of origin to exercise its right of taxation on the commercial revenue, regionally and legally, rather than resolving the problem by performing a transaction based on withholding tax (Hongler & Pistone, 2015: 2).

Hardware law, software law as well as the rules of tax law compatible with the principles of impartiality, efficiency, certainty and simplicity, effectivity and fairness and flexibility are the subjects that need to be taken into consideration collectively when establishing a new nexus (Hongler & Pistone, 2015: 40–43).

Virtual workplace concept is invented in an attempt to make it easier to call a commercial activity an establishment, in other words, to stretch the definition of establishment. This was intended to pave the way to call it an establishment by way of a tax nexus and to impose a tax, even if an activity, which is carried out

in a country, cannot be executed using a permanent establishment. This nexus works "as if it is a permanent establishment" in a sense and allows the country of origin to impose a tax on the income attributed to this establishment (Kara & Öz, 2016: 33). So, the nature of "tax nexus" becomes more of an issue.

The activities carried out without a physical connection, such as a website or mobile phone application, result in significant problems for the source countries, as well. Failing to establish a nexus with the country of income results in the formation of a tax-free (non-taxable) domain. This result has led to the idea that a remarkable digital presence can be referred alternatively in different situations. For instance, it was suggested that an alternative establishment can exist in the event that a number of agreements are made between a business carrying out digital activity and the customer(s) in the country of origin; the goods or services offered digitally are used widely in the country of origin; payments of large amounts are made from the country of origin to the business carrying out digital activity. However, in that case, some liabilities could be imposed on such business carrying out digital activity, nearly worldwide, which is not applicable (Budak, 2018: 85).

Although the digital economy appears to be an abstract cycle, it will be fair to say that it is recorded since the payments are made through the agency of financial intermediaries. Financial institutions keep a record of payers and payees of the payments. Therefore, it seems possible to identify at least the major global companies supplying digital services and get the financial institutions to withhold VAT based on the payments to be made for them from Turkey. It is for sure that a new legal arrangement will be required to get the financial institutions to withhold such tax. Finance Administration took a step similar to this approach, in the General Communique on Tax Procedure Law, Item No. 464, which was published in December 2015. The Communique stipulates that data, concerning the payments towards the selling and renting transactions performed online, will be transferred periodically in the electronic environment from the banks operating within the scope of the Banking Law No #5411 to RA (Revenue Administration) system. As can be seen from the provision of the communique, Finance Administration indicated that it would resort to using of the records of the banks, for some ongoing transactions in the digital economy. Concerning the services received electronically from overseas, the same method can be adopted and further to that, a legal infrastructure should be prepared, to withhold VAT (Ertaş, 2017: 139).

Theoretically, splitting a commercial income would also result in the distribution of the power of taxation. Therefore, a nexus (association with a permanent establishment) will always exist, physically or digitally or whatever, in a country

where the value is created (Hongler & Pistone, 2015: 23). On the other hand, distribution of the power of taxation ought to be evaluated regarding the utility theory. Since the primary utility of digital economy leads to proper functioning of a country's infrastructure (electricity, internet, communication, etc.), this situation will require that the power of taxation of the country, the infrastructure of which is used, should also be taken into account (Hongler & Pistone, 2015: 24).

In case a threshold is set depending on the number of users, the resulting outcome is to be assessed regarding the VAT, as well. If a threshold is set based on a certain number of users and the presence of a digital establishment is recognised when such threshold is exceeded, it is still unclear whether VAT is to be collected by the country to which the user is associated or the country where the enterprise is located.

An enterprise based in a contracting country will be deemed to have a permanent establishment in another contracting country if the enterprise earns more than …. (TL, EUR, USD, GBP, CHF, etc.) annually in such contracting country, through an electronic application, database, online, market area or storage, website advertising service or through an electronic application which has over 1000 individual users every month, residing in such contracting country (Hongler & Pistone, 2015: 3). The proposal in question was brought to adding it as clause #8 into the article #5 of the OECD Model Convention. The authors underlined that the term "user" here should be defined clearly and emphasised whether the persons who are subscribers or the persons who receive the service directly are supposed to be considered. Also, it was also expressed that the terms "database", "advertising services", "website", "each month" and "resident" need to be clarified, as well.

One of the views outlined in the literature is to adopt the principle of economic presence, instead of physical presence, for an establishment. Within this framework, as an example, when the number of commercial activities carried out in a country by a resident of another contracting country exceeds a certain threshold (e.g. $1 million US), it will acknowledge that an establishment is formed, so such income should be taxed in the source country. A concept of "virtual establishment" (virtual PE) was suggested, based on the idea that an establishment will be considered to have formed in case of the presence of a continuous and significant commercial activity in a country (Batun, 2014: 74).

3.6 Practices in Some Countries to Tax Digital Activities

Spanish Tax Court ordered that a company, which makes sales in Spain over an internet site based outside Spain (web-hosted outside Spain) although it is not a

resident of Spain, could be subjected to direct tax liability in Spain, based on its revenue earned from such sales, as a commercial income, within the framework of the approach "virtual establishment" (virtual PE) (Erdem, 2016:23).

"Diverted Profit Tax" that became law in 2015 in the UK is regarded as one of the leading steps taken by taxing the largest technology companies. "Diverted Profit Tax" targets the tax structures of large-scale taxpayers only. It advocates that the income earned as a result of the activities in the UK should be above a certain amount and also considers the overseas structuring and tax burden of UK group companies.

Australian Government launched "Australia Goods and Services Tax" act in February 2017 for the international service sales as well as digital products, to be implemented on the Australian consumers. This act introduced two major taxes. A brand new tax, called "Netflix Tax", was introduced into the consumption taxes act, to tax the foreign taxpayers offering entertainment services using the online subscription model. Moreover, a new tax liability, called "Amazon Tax", was launched in order to tax the foreign companies selling products in Australia by way of e-commerce (Uslu, 2017a: 152).

While the businesses can be monitored more strictly in e-commerce, within the scope of the Action Plan #7 of BEPS, with respect to the taxes collected on the revenue in the People's Republic of China, the Government of Vietnam announced its arrangement plans with regards to the establishment of tax liability, declaration, tax returns and tax payment obligations of foreign digital companies. On the other hand, India put a practice, called "equalisation tax", into operation, aiming at taxing the e-commerce-based transactions, to be effective from June 1, 2016. Upon this arrangement in Law, India imposed tax by 6 % on the payments made in cash or on account, to the limited taxpayers who do not have an establishment in India, with respect to the "specific services, such as the provision of online advertising, digital advertising space" (Kahraman, 2017: 3).

In 2016, South Dakota State of USA introduced its principle of nexus in its legislation. The law will enable the vendors, who do not have a physical presence for the sales tax based on the principle of an economic nexus, to be taxpayers. Tax liability threshold was determined as "the vendor has to make 200 separate sales or make a total of $100.000 US sales".

Belgian Government annulled the VAT exemption offered to the companies delivering online gaming service, upon the amendment to the law in 2016. However, an online game company escalated the case to the Constitutional Court on the ground that the amendment in question is against both the Belgian VAT law and straight games legislation. The Court cancelled the execution of the law, upon its recent decision, as it acknowledged the company to be right (SBC News, 2018).

4 Conclusion

Development of digital economy requires that the rules in every field affected by the economic activity be readdressed and rediscussed. In that sense, the tax legislation is one of the closely affected fields. The fact that the number of economic activities via internet in an electronic environment, as well as the users who enjoy such activities, keep increasing every year began to influence the tax revenue of the countries, as well and caused the formation of non-taxable areas by creating the unfair competitive environment. Although OECD and EU agree upon the fact that existing applicable international taxation rules remain incapable in taxing the digitalised economy, OECD members have not yet introduced a new and stable taxation rule in this respect at international level. As a short-term solution, OECD member countries adopted the taxation method, which is mostly collected based on the sales and it is mentioned that a long-term solution will be achieved in 2020. On the other hand, EU strives to introduce new rules and settle the problem on its own merits. However, there are still specific rules that have to be approved by the parliaments of 28 countries and also some lingering uncertainties and challenges encountered in the implementation by non-member countries

Primarily, the economic activities offered via the websites, cloud systems, the applications on mobile devices which are deemed as virtual workplace have long exceeded the limits of the tax-raising powers of the countries, thanks to their extensive features. Therefore, the outcome, likely to come out of either international or national works, favours the idea that the virtual workplace has to be redefined and taxation arrangements will be required, accordingly.

In this sense, the following considerations have to be resolved immediately:

- clarifying and defining the nature of digital products and services, comprehensively,
- defining and clarifying the considerations to be recognised as "establishment" in a virtual environment,
- how to assess the status of the limited taxpayers regarding the taxes collected on income,
- how and by whom the tax, collected on the expenses during the delivery of digital products and services, will be calculated and declared,
- how to address the matters in question when executing the double tax treaties.

It is evident that the concept of "permanent business establishment" should be replaced with the approach of economic presence, in electronic environments. Therefore, the definition of "digital establishment" ought to be reshaped and made, accordingly. Although tax agreements specify which activities will not be

regarded as an "establishment", activity definitions remain incapable, given the varieties of the activities in the electronic environment.

It is required that right amount of income should be taxed in the right country and the right amount when deciding on the taxable income of the associated organisations and therefore an automated data exchange has to be established between the tax offices.

Furthermore, another result that can be inferred from all these remarks is that it will not be a proper approach to consider each website or web server an "establishment". However, the traditional taxation principles and definitions are open to abuse and might create an unfair competitive environment since they remain incapable of comprehending the electronic commerce. On the other hand, the fact that a website or web server should be accepted as an establishment in any case and condition will lead us to a unifactorial and accordingly to uniform taxation. For instance, a matter to be taxed as an element of "agricultural income", without taking the existing taxation rules into account, needs to be taken into account and taxed as a "commercial income", with the establishment approach that is attributed to the websites. With regards to the element to be taxed, the distinctions set out in the current legal regulations will eventually be taxed as a "commercial income", by rendering them down to a single revenue item. Hence, despite what's been achieved so far since 1998, it is evident that more accurate assessments should be made in defining the digital workplace and previous assessments are still insufficient.

Considering that those offering electronic services are based overseas and have no nexus here, it is controversial how to control the applicability and whether or not it is applied. We are in the opinion that the most reasonable proposal that might spring to mind at this point would be that the nexus in such transactions should be connected to "payment", and the responsibility should be conferred to the "banks or similar financial institutions".

Mainly, the point agreed upon in OECD and doctrine is that the requirement that virtual establishment ought to connect its asset to certain thresholds (Income, user, agreement thresholds, spaces allocated to advertising, etc.) is the most concrete proposal at the moment. This matter has to be further discussed comprehensively, and the assessments have to be made based on these considerations. However, it is also essential that the terms such as electronic application, database, online activity area, storage, advertising services, website, user, monthly period, resident, total income and service be redefined.

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