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Master's Thesis

Methods of International Double Taxation Relief
Atleidimo nuo tarptautinio dvigubo apmokestinimo metodai

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ANNOTATION IN ENGLISH

This master's thesis explores the aspect of international double taxation, with a specific focus on its juridical trait. The study thoroughly examines and compares various relief methods, ranging from credit and exemption approaches to bilateral tax treaties, analyzing their implementations on both national and international scales. The study extends to global implications, shedding light on conflicts between taxation principles. An exploration of the practical implications of these measures in Turkey produces valuable insights into both unilateral and bilateral strategies. The concluding section assesses international double taxation treaties, with a particular emphasis on influential model conventions such as those presented by OECD and UN models, with an original method of Turkey. Ultimately, this thesis enriches the scholarly dialogue on international double taxation, providing valuable perspectives for policymakers, tax professionals, and scholars dealing with the ins and outs of this complex phenomenon. Based on results of examples and findings, conclusions are provided at the end of this thesis.

Keywords: relief method, situs, taxation technique, unilateral measures, exemption, Model convention

ANNOTATION IN LITHUANIAN
ANOTACIJA

Ši magistro disertacija tyrinėja tarptautinio dvigubo apmokestinimo aspektą, ypatingą dėmesį skirdama jo juridiniam aspektui. Tyrimas išsamiai nagrinėja ir lygina įvairius palengvinimo metodus, pradedant nuo kreditinės ir išimties požiūrio ir baigiant dvišalėmis mokesčių sutartimis, analizuodamas jų taikymą tiek nacionaliniu, tiek tarptautiniu mastu. Tyrimas plinta į pasaulines pasekmes, atskleisdamas konfliktus tarp mokesčių principų. Nagrinėjimas, kaip šie metodai įgyvendinami Turkijoje, teikia vertingų įžvalgų į abipusio ir dvišalio pobūdžio strategijas. Baigiamajame skyriuje vertinamos tarptautinės dvigubo apmokestinimo sutartys, ypatingą dėmesį skiriant įtakingoms modelio konvencijoms, tokiose kaip OECD ir UN modeliai, su originaliu Turkijos metodu. Galiausiai ši disertacija praturtina mokslinį dialogą apie tarptautinį dvigubą apmokestinimą, suteikdama vertingų perspektyvų politikams, mokesčių specialistams ir mokslininkams, susiduriantiems su šio sudėtingo reiškinio niuansais. Remiantis pavyzdžių ir išvadų rezultatais, šiame darbe pateikiamos išvados.

Pagrindiniai žodžiai: palengvinimo metodas, situs, mokesčių technika, vienašališki veiksmai, išimtis, modelio konvencija

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INTRODUCTION

Exploring the complex realm of global taxation, this master's thesis undertakes a thorough investigation of the diverse strategies used to tackle the widespread issue of double taxation. Examining both domestic and international measures, including model agreements, the research aims to uncover the intricacies involved in taxing income that crosses borders. The study goes further to examine Turkey's distinct approach, using a comparative perspective to comprehensively evaluate the country's strategies in lessening the effects of double taxation on businesses and individuals engaged in global economic activities.

Driven by the escalating difficulties arising from increased global workforce mobility and greater capital movements, the choice to focus on international double taxation as the central theme is based on its extensive impact on cross-border economic activities. The primary goal of the study is to offer a nuanced comprehension of this phenomenon, differentiating between economic and legal expressions, and elucidating the conflicting principles associated with taxation techniques.

When evaluating the relevance and novelty of the subject, the study not only adds to theoretical conversations but also tackles the practical implications for crafting fiscal policies. The study operates against a backdrop of tension involving jurisdiction principles, source principles, residence principles, and nationality principles. Within this context, the research delves into measures designed to alleviate the challenges of international double taxation.

As the research seeks to evaluate and compare unilateral and bilateral measures globally, particular emphasis is placed on Turkey's approach to double taxation problem. Aligned with the title of the topic, the aim of this research is to assess and compare the unilateral and bilateral measures employed globally to address international double taxation. The study seeks to provide a comprehensive evaluation of the effectiveness of relief methods. Incorporating Turkey into this exploration, the research aims to extend the analysis to include the unique approaches and challenges faced by Turkey in addressing the complexities of international double taxation. Through the integration of a comparative perspectice, the study seeks to provide a different assessment of the effectiveness of national measures, the complexities of international frameworks, and Turkey's strategies in navigating the challenges presented by double taxation. Hence, this study aims to shed light on how Turkey optimizes its fiscal policies to accommodate the demands of businesses and individuals engaged in cross-border economic activities, thereby adding depth to the ongoing dialogue on international taxation

The outlined tasks involve a thorough comparison of national (unilateral) methods, an investigation of international (bilateral) regulations, a detailed analysis of the implementation of these measures in Turkey, and an assessment of relief methods utilized in model conventions such as the OECD and UN models.

The intended ways and methods to carry out these tasks involve an extensive literature review. Drawing from books, articles, websites, as well as master's and doctoral theses, this study employs a qualitative approach to compare and analyze the various relief methods used globally. The main sources for this study consist of a diverse collection of literature from well-known scholars, authoritative publications, and relevant theses.. The synthesis of information from diverse sources aims to provide a comprehensive and well-rounded understanding of international double taxation.

This thesis covers three parts, each carefully analyzing the aspects of the problem in hand. In Part One, we explore the foundational elements of international double taxation, interpreting its concept, distinguishing between economic and juridical difference, and investigating the reasons for its occurrence. Part Two navigates through preventive and eliminative regulations, examining national methods like credit, tax sparing, exemption, and deduction methods, as well as international regulations covering full credit, full exemption, and bilateral or multilateral tax treaties. Shifting our attention to the specific context of Turkey, Part Three assesses the double taxation treaties and model conventions used to address international double taxation.

1. INTERNATIONAL DOUBLE TAXATION

Within the framework of the innovations brought by globalization, national markets have remained in the background and economic actors have competed with each other to take part in the international market. In order to take part in the international market, the cost of goods and services has become increasingly important for these economic actors. This is a phenomenon that should be considered natural, considering the parameters of the international economic arena; as goods and services that can be produced/delivered at low costs will have great competitiveness on the international platform. For this reason, investors are looking for countries where their goods and services can be supplied cheaply.

While the investor is looking for the country that best suits his budget, states have started to look for attractive methods to attract investment to their own country. In order to attract investors, countries benefit from various systems such as low-interest loans, tax deductions or incentives, build-operate-transfer models and judicial mechanisms that can be considered investor-friendly. While these regulations are being made to attract investors, it becomes necessary to take measures to avoid double taxation.

"International double taxation is one of the biggest obstacles to cross-border trade and investment relations and the freedom of movement of persons, goods, services, and capital between countries" (Rasmussen, 2011).

1.1. The Aspects of International Double Taxation

1.1.1. The Concept of International Double Taxation

In parallel with the rapid developments in industry and technology after the Second World War, international economic and commercial relations have become more intense. The quick development of world trade has resulted in the spread of labor and capital from owning countries to other countries, thus the phenomena of international investment and multinational companies have emerged. All these developments have brought several international financial and economic problems. One of these problems is the problem of international double taxation.

The urgency to eliminate or alleviate international double taxation has grown, given its potential to confer a competitive advantage in today's global economic landscape, marked by advancements in technology, digitization, and increased globalization. (Sarmento, 2023, p. 245)

Since double taxation affects the efficiency and competitiveness of exports of goods, external, international elimination of double taxation in order to represent a necessity to ensure an improvement of the economic relations at the international level (Radu, 2012 p. 404). Economic policies for international investments are of great importance for both capital importing and capital exporting countries. In particular, one of the important policy problems is the desire of both countries to impose tax for the income from international investments. (Tomoyalda, 2006, p. 192).

After the Second World War, great importance began to be given to the elimination of problems arising from tax reasons in commercial transactions, especially double taxation. As it is known, the main reason underlying both world wars was the need to resort to political and military methods to solve the problems in question, as a result of the lack of mechanisms regulating international economic activities. According to views in this direction, a new approach was adopted to solve international economic problems in order to avoid encountering similar situations again after the war. According to authors who argue that international trade will prevent military interventions, the possibility of war between countries decreases as international commercial relations gain intensity and stability.

According to a 2015 analysis on this subject, it is not possible for any military alliance to achieve stability if international trade does not develop. Additionally, in cases where international trade is developed, it is not possible for countries to exhibit aggressive military attitudes and be subject to such attitudes. Therefore, the intensity and stability of international trade, which increased after the Second World War from 1950 to the present, has resulted in a significant decrease in interstate wars. (Jackson, Nei, 2015)

Each state has absolute taxation authority within its national borders, based on its sovereign rights. It is considered ordinary for states to create a tax system in accordance with social, political, economic and financial conditions and to increase the number of individuals, institutions and events to be taxed within this tax system in order to keep their income sources high and to show that they have sovereign rights. In addition, it is normal that they tend to expand their taxation areas. (Tokmakkaya, 1996, p. 78) The right of taxation is a sovereign right and therefore is basically exercised based on the discretion of each nation. Thus, every nation often imposes tax on the domestic source income of foreign corporations and nonresidents, not to mention on the worldwide income of domestic corporations and residents. (Ohno, 2010, p. 288)

Avoidance of double taxation is being dealt at both international and national levels, especially for federal republics that can impose the same income at state and federal levels (Sherman, Brinker, 2012).

Based on the information shared above, double taxation can be defined in the broadest sense as the collection of similar taxes in at least two countries, through the same taxpayers, on the same tax subject within the same periods. (Barthel *et al.,* 2009, p. 2)

According to Radu, international double taxation refers to the obligation of the same taxpayer to pay income or corporate tax in more than one country (Radu, 2012). Thus, it can be described as having to pay the same type of tax in two different states: one being that of the origin of the income and the other being the taxpayer's declared residence (Sarmiento, 2023, p. 245). It can be defined in the shortest way as "the taxation of the same person or the same thing twice over". (Seligman, 1895)

OECD (Organization for Economic Cooperation and Development) states that the international juridical double taxation can be defined as "imposition of comparaple taxes in two (or more) States on the same taxpayer in respect of the same subject matter for identical periods. where more than one country imposes comparable taxes on the same taxpayer, on the same subject matter, and for the same time period. (OECD, 2019)

Double taxation is the higher concept of international double taxation. In other words, double taxation can be both national and international. Another classification also exists, namely legal double taxation and economic double taxation. International double taxation, defined as a type of double taxation, means that the same tax subject is taxed separately under the tax laws of more than one state. In international juridical double taxation, the same taxpayers are taxed by more than one state on the same tax subjects. (Yaltı Soydan, 1995, p. 3).

On the other hand, national double taxation is the overlap of these powers between the relevant units that share the taxation authority due to the organizational structure of a state (Yaltı Soydan, 1995, p. 11). It is a concept that arises in situations arising from the organizational structure of the state. It can be defined as the overlap of taxation powers distributed to various political divisions within the same state, for reasons such as fiscal federalism or the delegation of political authority to subunits (Bayar, 2006) In that sense, it is stated that double taxation also includes the meaning of "excessive taxation" in terms of overlapping taxation powers. (Rohatgi, 2005, p. 15) According to another definition, international double taxation occurs when two or more countries have jurisdiction over the same asset, income or transaction (Pinto, 2017, p. 1). By this definition, it is emphasized that international double taxation arises from the conflicting tax authorities of the countries.

Taxation may generally be requested by the tax authority in one country based on the taxpayer's citizenship or residence, while in another country taxation may be based on the location of the source of income. (Barthel *et al.*, 2009, p. 2) Double taxation is a problem arising from the simultaneous application of two principles, namely, when the principle of residence and the principle of source appear simultaneously in relation to the same income of the same taxable person. (Erdős, Kiss, 2020)

Ohno brings a simple suggestion to this problem by stating that if both parties agree to adopt either source taxation or residence taxation, the problem of double taxation can be solved (Ohno, 2010, p. 292). In this sense, it can be concluded that states can avoid the problem of international double taxation by restricting their taxation powers. (Jimon, Dumiter, 2016, p. 2)

The phenomenon of international double taxation may arise not only due to the different structures of tax systems, but also due to different concepts and criteria underlying taxation (Buziernescu, Antonescu, 2008, p. 2734). Therefore, international double taxation arises not only from the worldwide income or residence principles adopted by countries, but also from the different definition of taxation among countries.

Therefore, it is safe to say that international double taxation is a problem that needs to be prevented for a better global economical environment as OECD states, “its harmful effects on the exchange of goods and services and movements of capital, technology and persons are so well known that it is scarcely necessary to stress the importance of removing obstacles that double taxation presents to the development of economic relations between countries.” (OECD, 2019)

International double taxation contradicts the principles of justice and equality in taxation as well as the principles of modern taxation (Kalaycıoğlu, 2017, p. 3). Juridical double taxation is contrary to tax justice because it imposes an excessive tax burden on certain taxpayers. In order to avoid juridical double taxation, states must limit their taxation powers, and in order to avoid economic double taxation, in addition to the other, they must harmonize their tax systems to a certain extent. (Çağan, 1982, p. 222)

For these reasons given above, countries are trying to avoid international double taxation either by reforming their own legal systems or by signing international double taxation agreements with various countries. Through these agreements, various principles and concepts that oversee tax law are used and efforts are made to uniformize the taxation system internationally. In this way, it is aimed to prevent double taxation.

Nevertheless, the original and initially sole purpose of the global tax regime was to mitigate international double taxation in order to liberalize international trade and investment. (Rixen, 2011, p. 205)

International double taxation occurs in two ways: international juridical double taxation and international economic double taxation. The literal meaning of international double taxation corresponds to international legal double taxation. Our study only consists of juridical double taxation.

1.1.2. The Difference Between Economic – Juridical Double Taxation

Double taxation can include both judicial and economical references. Starting with the **judicial double taxation**, it occurs in the situation in which two or even several states enable taxation for the same income or capital; meanwhile, **economic double taxation** produces in cases in which two different persons are taxable upon the same income and/or capital. (Dumiter, 903)

International juridical double taxation can be defined as “imposition of comparaple taxes in two (or more) States on the same taxpayer in respect of the same subject matter for identical periods. where more than one country imposes comparable taxes on the same taxpayer, on the same subject matter, and for the same time period. (OECD, 2019)

Whereas international economic double taxation is the taxation of the same income in the hands of different persons (OECD, 2019). From the definitions made by the UN and OECD that have prepared Model Conventions on the subject, it is seen that these agreements aim to avoid international juridical double taxation, and it is stated that the avoidance of economic double taxation is not among the objectives of tax agreements.(Van Weeghel, 1998, p. 34).

Double Taxation Treaties are generally concerned with international juridical double taxation and, to a lesser extent, with economic double taxation. (Jogarajan 2018, p. 7)

1.1.2.1. Economic Double Taxation

In economic double taxation, the same tax subject is taxed in the hands of different taxpayers. In general, economic double taxation occurs when subsidiaries located in different countries enter into relations with each other. (Lang, 2020). In this respect, the fact that the economic event that gives rise to the tax is the same constitutes the essence of the issue. (Işık, 2014, p. 30).

Similarly, the levying of tax obligations on multiple individuals by more than one state on the same taxable item represents economic double taxation in an economic context. (Öncel, Kumrulu ve Çağan, 2010, p. 58). In other words, economic double taxation means when the tax administrations include exactly the same income in the tax base of different taxpayers (Lang, 2021).

Let us look at this with an example. When income tax is imposed on distributed profits after corporate tax is levied on a company's corporate income, economic double taxation arises at the national level. An illustration of international economic double taxation is the case where, for example, Germany taxes the financial leasing payment made by a German entity to a French entity for an investment, even though France does not allow the expense to be recognized as a deduction. As indicated in this example, while economic double taxation at the national level may arise from preferences related to the country's tax system, international economic double taxation can arise from conflicts in states' taxation powers.

1.1.2.2. Juridical Double Taxation

The most significant difference between economic double taxation and juridical double taxation arises in the element of the taxpayer. In economic double taxation, the taxation of the same tax subject in the hands of different taxpayers is undelined whereas in juridical double taxation, having the same taxpayer is particularly crucial.

Juridical double taxation, similar to economic double taxation, can arise both domestically and internationally. On the national level, juridical double taxation stems from conflicts of authority between federated entities and the central government, especially in federal states. This challenge is more common in countries practicing fiscal federalism or the transfer of political authority to local units.

The OECD provides the following definition of juridical double taxation: “International juridical double taxation can be generally defined as the imposition of comparable taxes in two (or more) States on the same taxpayer in respect of the same subject matter and for identical periods.” (OECD Commentaries I-1 paragraph 1.)

International juridical double taxation constitutes the subject of this work. For the sake of clarity, throughout the rest of this work, we will use the term "international double taxation" instead of "international juridical double taxation".

1.1.3. The Elements of International Double Taxation

As we have mentioned previously, international double taxation is based on the elements of the same taxable subject being taxed within the same period. (Radu, 2012, p. 404)

The following elements must be present to speak of international double taxation:

More than one state wishing to levy tax using sovereign powers on the same taxable subject: The most fundamental element of international double taxation is the overlapping of taxation powers of multiple states due to the increasing international dimension of trade and investments (Özlü, 2019, p. 6). States apply their tax laws based on sovereignty to everyone within their borders (Kızılgül, 2019, p. 14). As a result, each state taxes both its own citizens and foreigners within its borders, and sometimes this authority even affects citizens living outside the country (Yılmaz, 2019, p. 4). Accordingly, the basic aspect in the emergence of double taxation is the desire of multiple states to tax the same source. Therefore, the overlap of the taxation powers of multiple states, while being an element of international double taxation, is also its most fundamental cause.

The same individuals being subjected to taxation: In the context of international double taxation , a crucial requirement is the uniformity of the taxpayer. To be considered a taxpayer, whether an individual or a legal entity, it is necessary to be subject to the tax authority of a state. This allegiance can be established through political, economic, or residency connections between the state and the individual. In the present day, tax liability cannot be solely explained by citizenship. States, in exercising their sovereign authority for taxation, take into account both the taxpayer and the relationship between the taxable income source and the state (Özlü, 2019, p. 7).

The subject of taxation (the object of the tax) being the same: The aspect of having the same tax subject, which is one of the fundamental elements of international double taxation, implies that the taxable event is the same (Altaş, 2010, p. 36). Therefore, if the income component realized by a taxpayer is considered as triggering the tax liability according to the tax laws of multiple states, we can then discuss the concept of international double taxation.

Uniform Taxation Period: The uniformity of the taxation period, which is one of the fundamental elements of international double taxation, implies that the occurrence time of the taxable event aligns in both countries (Yılmaz, 2019, p. 39). In other words, it refers to the economic event subject to taxation happening simultaneously in both countries.

Indeed, the consistent imposition of similar taxes in different periods is in accordance with taxation principles. It is crucial to understand the uniformity of the taxation period as being same of the occurrence time of the taxable event. It should not be confused with concepts such as assessment time, payment time, budget year, which may vary in different tax systems among countries. (Yaltı Soydan, 1995)

The Similarity or Consistency of the Tax Type: In addition to what we have stated above, another aspect can be included into discussion, the Similarity or Consistency of the Tax Type. The subject is regulated in Article 2 of the OECD Model Tax Convention as "The Convention shall apply also to any identical or substantially similar taxes that are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes." (OECD, 2019) Thus, states relying on the model convention cannot exclude the taxes listed in this article by assigning them different names.

In the third paragraph of Article 2 of the model convention, a list of the taxes covered by the agreement is provided based on those in effect on the date of the agreement's signing by the contracting states. This prevents disputes among states over the concept of similar taxes.

1.1.4. The Reasons of International Double Taxation

As the most general definition, fiscal sovereignty expresses the authority of the state to collect income and engage in expenditure within its country and among its citizens. This term encompasses both legislative rights and executive powers as facets of the state's sovereign authority (Rohatgi 2005). The taxation authority, which is the most crucial power held by the state in the fiscal realm, is exercised within the sovereign boundaries of that state, where the state exercises its exclusive jurisdiction, in an area determined by international law. Although this authority is not absolute and unlimited, states aim to utilize these powers to the utmost extent by adhering to various taxation principles. (Pazarcı, 2009, p. 173)

The internationalization of investment makes it more difficult for tax authorities to capture income. It is often more difficult to capture foreign source income than to capture domestic source income. If the governments do not act to prevent this from happening, investors might choose to avoid tax, which would result in international tax avoidance. As it shows itself as a problem common to many countries, countries have cooperated with one another to resolve the issue by concluding tax treaties. (Ohno, 2010, p. 288)

Above, we discussed the elements of double taxation, which include the same individuals being subjected to taxation, the subject of taxation being the same, uniform taxation period and the similarity of the tax type. On the other hand, the most significant element, and at the same time the fundamental cause of international double taxation, is the existence of taxation powers of multiple states, rooted in general reasons related to the flow of capital and labor.

1.1.4.1 Economical Reasons – International Workforce and Capital Flow

Since the 18th century, rapid developments in industrialization and technology worldwide have accelerated the exchange of information between countries, resolved issues of time and space constraints in transportation and communication, and consequently reduced costs. The transition to mass production has led to a rapid increase in supply. Simultaneously, producers have sought new markets and devised methods to minimize costs. Local manufacturers, while expanding to international markets, have also established production facilities in different countries to minimize costs. In other words, companies engaging in international procurement and sales have started to acquire an international structure. These developments in the commodity market have also been observed in the capital and, to some extent, the labor market. (Yaltı Soydan, 1995, p. 9)

The increase and acceleration of capital and labor movement between countries have significantly contributed to global prosperity. As the transfer of capital and technology from developed countries with high technology and abundant capital has increased, so has the transfer of labor from developing countries, benefiting both groups of countries. The shift of capital and advanced technology from developed countries to developing ones, coupled with the movement of the labor factor from developing countries to developed ones, is an economic factor leading to double taxation (Kızılgül, 2019, p. 24). The need for developing countries to tax capital and technology imports has brought about the issue of whether to tax these gains in the country where income is generated (source country) or in the country where the foreign capital is resident (residence country) (Bayar, 2006, p. 8).

Governments and international organizations have made significant efforts to facilitate the increase and free movement of capital and labor internationally, producing positive results. Consequently, the rapid increase and global movement of capital, labor, industry, tourism, and technology transfer, engaging in cross-border activities freely, have been identified as the fundamental cause of the occurrence of double taxation (Tuncer, 1974, p. 13).

In today's context, the taxation of the income from foreign capital investments has gained significant importance due to the increase in these investments. Especially, the need of developing countries for capital and technology imports has raised the question of whether these gains should be taxed in the country where income is generated or in the country where the foreign capital is resident. While the residence country's technological knowledge plays a significant role in the transformation of investment into profit, on the other hand, the source country's labor and natural resources are utilized. Therefore, tax laws prepared by states with the idea that taxation authority should reside within themselves have given rise to the issue of double taxation.

1.1.4.2. Conflict of Principles Related to Taxation Technique

The primary reasons leading to international double taxation arise from the taxation powers due to the national sovereignty of states. The legal situation causing a clash of sovereignty powers between countries is the adoption of different principles in determining taxation powers by those counties. Generally, states apply three distinct principles in terms of taxation technique: the source principle, the residence principle, and the nationality principle.

Countries can apply all these principles quite differently in terms of taxation. The acceptance of one of these principles or the application and interpretation of each principle in different forms can lead to international double taxation.

The authority of taxation, deriving its legitimacy and source from sovereignty, can only be applied within the scope of sovereignty. Therefore, if international law limits sovereignty, it also restricts the authority of taxation. When international law is accepted to allocate the scope of a state's sovereignty, it is necessary to acknowledge that this scope is also valid in terms of taxation authority. (Yaltı Soydan, 1995).

In this context, the emergence of the issue of international double taxation stems from the complexity that arises when taxation authorities of the states are not limited. To identify the reasons for this complexity, it is necessary to examine initially the international principles of taxation with respect to jurisdiction adopted by states. International jurisdictional principle of taxation can be analyzed by looking at the source, residence and nationality principles.

1.1.4.2.1. Jurisdiction Principles

1.1.4.2.1.1. Source Principle

The first of the taxation principles that lead to the conflict of taxation authorities due to the determination of different taxation systems is the source or situs principle. Generally, in terms of domestic law, the place where activities generating commercial income take place is considered the source of such income. (Akçaoğlu, 2012, p. 41)

The basis of the source principle indicates that the taxpayer can be taxed only on the income earned domestically. The term used for this situation is defined as limited tax liability. The source principle is the application of territoriality principle within the tax law. (Yaltı Soydan, 1995, p. 18). According to a definition by Avila (2012, p. 2), this territoriality principle indicates that individuals benefiting from sources acquired within the territory of a specific country are subject to taxation in that country, even if they are not residents there. Therefore in relation to the principle referred to as the territorial or limited taxation principle (Panayi, 2007, p. 3), the basis for taxation is considered to be the place where income arises or where goods are located.

In this regard, while source principle does not bring a distinction for the taxpayer, it is observed that this principle relies on an “economic connection based” territorial sovereignty and is more preferred by capital-importing and developing countries. (Öncel *et al.*, 2015, p. 57).

The number of countries that completely base their tax system on the source principle is limited, and such practices are encountered in tax haven countries that only tax transactions taking place within their own borders, where taxpayers aiming to avoid or evade taxes are attracted (Nazalı, 2015).

According to this principle, what matters is the source of the tax; the right to tax the subject matter of the tax derived from that source belongs to the country under whose sovereignty the tax source is located. (Uluatam 1995, p. 63). The main element is not the individual but the element of income. The state subjects the taxable matter and events giving rise to taxation under its sovereignty. The resulting legal situation is based on the principle of establishing economic relationships, and the residence and nationality of the taxpayer no longer have an impact (Yaltı Soydan, 1995, p.18).

For example, a person who is a citizen of Italy but resides in Turkey is subject to taxation by the Turkish state on the income earned within the borders of Turkey. In the case of source principle, the individual's residence being in Turkey or Italy will not alter the taxation authority of the Turkish state.

Generally, source countries develop tax policies that reduce the tax burden on foreign investors investing in their countries. The reason is that, since foreign investors use domestic production factors, the economic return of foreign investors may outweigh the waived tax revenue (Öz, 2005, p. 31). While taxation provides the authority and opportunity for developing countries to take a share from the value-added created in their own countries, difficulties arise in determining where the income originated and how taxes will be shared between states. (Budak, Yakar, 2007, p. 138) as states can define income differently, income elements may vary accordingly and the conditions for earning income can also differ from one state to another. Another drawback of the source principle is that the authority of taxing the investments made abroad by resident institutions in a country, is given to the country where the investment is made. As a result, the resident state may suffer a tax loss to that extent (Egeli, Özcan, 2014, p. 78).

The source principle is more suitable for the economic structures of developing countries. Developing countries are primarily importers of capital. In these countries, the number of international companies is low, and they have limited influence in international trade. Additionally, their foreign investments and foreign incomes are at very low levels. However, they have foreign capital investments, and the taxation of foreign capital incomes is a significant source of revenue. Since developing countries find it challenging to accumulate the necessary capital through voluntary savings, the most intelligent way for these countries to increase capital accumulation is through public savings. As taxation is the most significant source of public savings, these countries need to prioritize the taxation of income generated within their jurisdiction.

1.1.4.2.1.2 Residence Principle

Another principle of taxation is the residence principle. Based on a personal connection, this principle is also referred to as worldwide taxation. (Panayi, 2007, p. 3) The residence principle is the principle where tax residents of a country are subject to taxation on their worldwide income, a greater portion of taxation rights are allocated to a residence country. (Dauer, Krever, 2012). Taxation is primarily based on residence. The residence principle is a relatively new concept compared to the source principle. In this principle, the reason for considering the individual's residence as the taxation criterion is the idea that those benefiting from the public services provided by the state should contribute to the financing of these services (Canyaş, 2016, p. 46).

In the residence principle, it can be said that the legitimacy of the taxation process is gained by the presence of the residence of the person who owns the income or wealth subject to the taxation in that country. In this case, the national connection of the state exercising the taxation authority will be highlighted not with the taxed subject but with the taxpayer (Yaltı Soydan, 1995, p. 19).

It is important to determine what is intended by presence of residence here. In the concept of taxation, it means the fiscal domicile. Fiscal domicile is where taxpayers reside, live, or conduct their business. For individuals, it can be a home or workplace, while for legal entities, it can be the legal headquarters, place of effective management, or similar places. In this respect, it can be said that it has a broader conceptual framework than private residence (Kızılgül, 2019, p. 30).

In the taxation based on the residence principle, which is the fundamental concept of the taxation, the scope of obligation has been broadly defined as the taxation of both domestic and foreign income. The term used for this situation is called unlimited (full) tax liability (Yaltı Soydan, 1995, p. 19).

The residence principle aims to prevent capital flight abroad, increase total tax revenue, and ensure equality in the taxation of domestic and foreign income. (Bahar, 2008, p. 24). Residence principle is said to have the power to create fair taxation and an efficienct investment atmosphere. On the other hand, it is desirable for a government to impose a tax on the worldwide income of domestic corporations and residents However, capturing their foreign source income is often more difficult than capturing their domestic source income. (Ohno, 2010, p. 292) The challenge in taxation based on this principle lies in monitoring all of an individual's activities and accurately determining their income (Bahar, 2008, p. 24).

The residence principle is more suitable for the economic structures of developed countries. Developed countries are generally net exporters of capital and have investors actively involved in international trade. These countries aim to retain the taxing rights on income generated from these activities. If developed countries accept the residence principle, they will have the right to tax the foreign income earned by individuals and entities in their country, including income from exports and investments (Kocayusufpaşaoğlu, 1969, p. 101). In that sense, this principle can also be summarised as shifting the taxing rights from the source country, which is capital-importing country, or in other words, developing country; to the residence country, which is capital– exporting country, in other words developed country. (Dauer, Krever, 2012).

As a result of this, for developed countries, emphasizing residence taxation takes preference due to their extensive capital exports. Conversely, in developing countries where capital imports often exceed exports, prioritizing residence taxation is not advantageous. Instead, these countries seek to broaden the application of source taxation (Başok, 2016, p. 49). Consequently, when a tax treaty is established between a developed and a developing country, or between two developing nations, the scope of source taxation in that treaty tends to be broader compared to the OECD Model Tax Convention.

While the residency principle is generally used in the literature, the starting point of this principle is the personality principle. The personality principle is based on the form of the relationship established between the state and the individual. The relationship with the state is established in two forms: 1- residency, 2- nationality. Especially based on the connection of nationality, countries tend to extend their tax jurisdiction to the international arena. The taxation of international earnings is attempted to be legitimized through the citizenship relationship.

1.1.4.2.1.3 Nationality Principle

The nationality principle, being complementary to the residency principle, is mostly utilized by countries with significant foreign capital investments but have not yet completed their economic development. This principle is less frequently applied compared to the residency principle and is more of a complementary feature to it (Uluatam and Mehtibay, 2001, p. 63). In this principle, the tax obligation is tied to citizenship, and the country exercising tax jurisdiction taxes the income and wealth of those connected by citizenship worldwide. As a consequence, foreign individuals earning income in a country can be taxed based on unlimited tax liability by the country of which they are citizens.

Nationality (citizenship) is formed through the establishment of a political connection between the state and individuals. The application of tax jurisdiction according to the nationality principle covers the taxation of income and wealth elements obtained by the citizens under the sovereignty of the state both within and outside the country. (Canyaş, 2016, p. 45).

Regarding the nationality principle, it is observed that there are some issues encountered in practice, with one of the main problems being the determination of the nationality or residence of legal entities (Başak, 2005a, p. 108). As a solution to this, it is generally accepted that the legal domicile of corporations is considered to be the country with which they have allegiance (Kızılgül, 2019, p. 32).

1.1.4.2.2 The Conflict of Taxation Powers

States can base their taxation powers on either the residence principle or the personal principle. When exercising these principles, states choose between them by considering economic justifications and their international interests. Therefore, it is possible to encounter different practices among countries.

The adoption of different principles by states alone does not pose a problem. However, when individuals engage in trade relationships with multiple countries, they fall into the tax jurisdictions of these countries, and then problems arise. Even countries that have adopted similar principles and methods may vary in their interpretation of terms and events in their tax laws. This variation can lead to conflicts between the taxation powers of different countries, ultimately resulting in the concept of double taxation (Yaltı Soydan, 1995, p. 23).

In this context, one example of double taxation caused by this conflict, can be given from Turkey. According to our example, double taxation occurs when a foreign state accepting the nationality principle, taxes a citizen who qualifies as a resident in Turkey according to the second paragraph of Article 4 of the Income Tax Law, provided they reside continuously in Turkey for more than six months. In this case, both countries have taxation powers. Thus, a conflict of powers to tax emerges. Another example is the clash between the taxation powers of a state adopting the residence principle, subjecting the individual to full liability, and a state adopting the source principle, subjecting the individual to limited liability.

1.1.4.2.2.1 The Conflict Between Unlimited (Full) Taxpayers

The conflict among full taxpayers who are the subject of both domestic and worldwide taxation, can be approached in three ways (Yaltı Soydan 1995, p. 23).

Conflict between a state adopting the nationality principle and a state adopting the residence principle: In this situation; individual A, being a citizen of country Z where they currently do not reside, is subject to taxation on their worldwide income due to the applicability of the nationality principle in country Z. Additionally, residing in country Y, where the residence principle is adopted, A will also be taxed on their worldwide income earned in Y.

Conflict between two states adopting the residence principle, otherwise can be called as conflict of residence: In this scenario, both countries Y and Z adopt the residence principle. Individual B, residing in country Y, is subject to taxation by Y. However, B has spent more than 6 months of the last calendar year in country Z. Consequently, Z also has the authority to tax B for the same tax year. From a legal entity perspective, a corporation might be considered a resident of country Y due to its incorporation there, yet it could also be deemed a resident of country Z if its management and control are situated in that jurisdiction. This dual residency scenario leads to both countries imposing taxes on the company's income, thereby causing the issue of double taxation. (Jogarajan, 2018, p. 8)

iii. Conflict between two states adopting the nationality principle: The subject of the third scenario is individual C, who is a citizen of both countries Y and Z. Both countries follow the nationality principle. Therefore, both Y and Z have the authority to tax individual C.

As a result, all of these given examples ends up with the problem of International Double Taxation.

1.1.4.2.2.2. The Conflict Between Unlimited Taxpayer and Limited Taxpayer

This is the most common situation of double taxation. The country of residence, which adopts the residence principle, has the authority to tax the individual on their worldwide income. However, the individual, engaged in commercial activities as a limited taxpayer in another country that adopts the source principle, is obligated to pay taxes to that country for the income generated from those activities. Thus, the tax authority of two different countries conflicts. In other words, this is source-residence conflict, whereby one country taxes an amount on the basis that it is sourced in that country, while another country taxes the amount on the basis that it is the income of a resident of that country. As an illustration, consider a scenario where a resident of country A possesses an investment property in country B, generating rental income within the borders of country B. In this case, country A imposes taxes on the income based on the taxpayer's residence, while country B levies taxes on the same income based on its source within its jurisdiction. Consequently, the taxpayer experiences the challenge of having the same amount subjected to taxation in both countries, leading to the occurrence of double taxation. (Jogarajan, 2018, p. 8)

1.1.4.2.2.3. The Conflict Between Limited Taxpayers

An individual that is not a resident in both countries earning income from both countries will be subject to limited taxation in both countries. Double taxation in this scenario can only occur if both countries adopt the source principle, Thus, it can be referred to as a conflict of source. The reason for this type of double taxation is that countries have established different criteria regarding the origin of income in their respective countries (Balcı, 2003c, p. 16).

When a taxpayer, not meeting the criteria for residency in either country, generates income or possesses wealth in one country through a business situated there, both the country hosting the business and the country where the income or wealth is acquired may impose taxes under the source principle. To resolve potential conflicts arising from the dual application of the source principle, Double Taxation Agreements may address these issues by outlining specific source rules for distinct types of income, aiding in the determination of the country of source. (Jogarajan, 2018, p. 8)

International Double Taxation arising from conflicting source principles, has been left out in preventive and elimination models presented by both the Organization for Economic Cooperation and Development (OECD) and the United Nations (UN). This exclusion is clarified by specifying in the agreement models that it applies solely to individuals residing in at least one of the countries participating in the agreement.(OECD, 2019) Therefore, individuals without residency in any of the countries cannot benefit from of the agreement's provisions.

1.1.4.3. The Global Effects of International Double Taxation

The most significant impact of international double taxation in global scale is the loss of effectiveness in the international allocation of resources (Saraç, 2006, p. 88). Additionally, international double taxation can result in different levels of taxation for taxpayers, even though they are subject to similar taxable events, leading to unequal tax burdens. Consequently, inequality in taxation arises (Uluatam, Methibay, 2001, p. 60-61).

Double taxation adversely affects competition conditions among countries, hindering the free movement of production factors and reducing the expected benefits of international division of labor. Moreover, taxpayers being obliged to pay double taxes on foreign investment incomes hinders the international circulation of capital, leading foreign-sourced investments to countries where there is no risk of double taxation (Saraç, 2006, p.

88). At this point, it is possible to say that double taxation has distorting effects on international capital flows, thus having a negative impact on globalization (İnce, 2013, p. 6). Economically, taxes represent increased production costs for producers. Therefore, producers subject to international double taxation may either withdraw from production due to increased costs or witness an increase in tax evasion and tax smuggling cases (Berkay, Armağan, 2011, p. 91).

2. PREVENTIVE AND ELIMINATIVE REGULATIONS FOR INTERNATIONAL DOUBLE TAXATION

One of the most significant characteristics of the contemporary world is the intensifying interaction between economies due to the increasing flow of goods, capital, and people across countries. Nowadays, neither capital and technology nor human resources can be associated with a single state. On the contrary, movements of capital investments and labor are becoming increasingly internationalized in both scope and nature.

Especially as a result of the international movement of capital, inevitable situations have arisen, such as the establishment of foreign-owned companies, the expansion of companies within the holdings to different countries, the creation of branches by companies in foreign states, and the intensification of credit relationships where creditors and debtors are located in different countries (Özlü, 2019, p. 21). As a natural consequence, individuals and organizations have started to generate income in multiple states, giving rise to the issue of which state has the authority to tax the said incomes (Karaldı, 2015, p. 22).

The imposition of taxes by countries beyond their borders is subject to minimal constraints under international law. Consequently, the resolution of double taxation issues often falls within the scope of domestic or unilateral actions. To address juridical double taxation, numerous countries have incorporated provisions into their domestic laws, specifically designed to unilaterally mitigate the impact of such taxation challenges (Holmes, 2014, p. 103). However, achieving this goal by means of unilateral legislative measures tends to be more difficult, as every country has the purpose to have a higher tax revenue (Radu, 2012, p. 405). Differences in the tax policies of states and the diversity of economic conditions result in the inadequacy of unilateral measures taken by some states. States' goals of collecting more taxes economically and the systems established in this regard make it practically impossible to overcome double taxation solely through domestic regulations (Akbay, 1991, p. 4).

In practice, while countries may prefer unilateral measures, parallel to the increasing trends of globalization, they generally attempt to address these issues through bilateral or multilateral agreements nowadays (Balcı, 2003b, p. 17). Essentially, international agreements are said to aim at developing domestic regulations in the international legal sense to avoid double taxation (Uckmar, 2012, p. 164).

Avoidance of double taxation is accepted as a responsibility primarily to be addressed and prevented by the country where the taxpayer is resident. (Başok, 2016, p. 30). An example can be given in this regard. Assuming that a resident individual in the

Netherlands earns employment income subject to Turkish income tax in accordance with Article 15 of the relevant agreement in Turkey. And according to the relevant agreement and Dutch domestic law, this income will be subject to tax in the Netherlands. Hence, double taxation on the same income will arise. To prevent this double taxation, it will be the responsibility of the Netherlands, where the individual resides. In this sense, the income taxed in Turkey for the purpose of preventing double taxation while being taxed in the Netherlands will either be completely exempted from tax in the Netherlands (exemption method) or allowed to offset the tax paid in Turkey against the Dutch tax (credit method). (Öcal, 2010, p. 7).

In today's world, there are countries that choose either the source principle or the residence principle, and there are countries, like Turkey, that apply both methods under specific conditions. The existence of different methods leads to double taxation. However, if all states could agree on the same method and its implementation, there would be no need to talk about double taxation on an international scale. Yet, due to the natural consequence of countries having different political and economic perspectives, such a scenario does not seem feasible.

The prevention or elimination of international double taxation will have positive effects such as the fair distribution of tax revenues among states, ensuring tax justice, preventing discrimination, and contributing to economic development and progress (Yaltı Soydan, 1995, p. 32). States employ various methods at both the national (unilateral) and international (bilateral) levels to eliminate international double taxation. (Soydan 1994, p.69) Unilateral (national) methods and tools include methods based on the tax; credit method and tax sparing method. Methods based on the tax base are considered as exemption method and deduction method. Bilateral (international) methods and tools, on the other hand, are regarded as credit and exemption method, and bilateral agreements. Additionally, this section will also cover the national methods applied by the Republic of Turkey.

2.1. National (Unilateral) Methods and Instruments for International Double Taxation Relief

In resolving the issue of international double taxation, countries resorting solely to unilateral measures is only possible if and only if a closed economic system is adopted with no dealings with foreign countries. In today's practice, countries generally emphasize unilateral measures, but parallel to the increasing trends of globalization, they also seek to address this issue through bilateral or multilateral agreements. (Başak, 2005b, p. 59).

Unilateral regulations made by countries in their national legislation to avoid double taxation are related to the conflicts arising between the residence principle and the source principle. This is because countries typically tax resident full taxpayers on their total income from both foreign and domestic sources, while taxing non-resident limited taxpayers only on income earned domestically (Balcı, 2003, p. 17). For the elimination of double taxation, unilateral measures taken at the national level rely on states limiting their taxation powers over foreign sources through legal regulations. National regulations aimed at avoiding international double taxation are fundamentally related to technical adjustments of taxation (Terzi, 2017, p. 79). These methods can be diversified as follows: methods based on tax; credit method and tax sapring method, while methods based on the income; application of the exemption method and deduction method.

2.1.1. Credit Method

The credit method is one of the most commonly used approaches to avoid double taxation. This method allows for the deducttion of taxes collected in advance from a taxpayer against the overall tax liability calculated at the end of the year, under certain conditions and methods.

The credit method differs significantly from the exemption method. As Zimmer (2009, p.137) suggests, instead of excluding foreign income from consideration, this method includes foreign source income in the tax base of the State of residence. (Zimmer 2009 p. 137)

In other words, double taxation is eliminated by the State of residence providing the taxpayer a credit for tax paid in the State of source, which entails that tax otherwise payable in the State of residence is reduced by the foreign tax paid (Arnold 2002 p. 37).

In the credit method, a state that adopts the residence principle in taxation calculates taxes based on the income sources of taxpayers, both within and outside the country. However, taxes paid in a foreign country at its location are deducted against the calculated total tax. In this case, the country of residence treats the tax paid in the foreign country as if it were a tax paid in its own jurisdiction.

When the tax rate applied in a foreign country is lower than the domestic tax rate, the residence country collects the part that exceeds the tax applied in the foreign country. On the contrary, if the domestic tax rate is lower; the residence country cannot collect any tax, and the excess paid in the foreign country is not refunded. To truly benefit from this method, the domestic tax rates must be higher than those in the foreign country (İnce, 2013,

p. 8). When the source country imposes lower taxation compared to the residence country, it is the capital-exporting country rather than foreign investors that benefits from the deductions made by importing countries. Consequently, it becomes apparent that capital-importing countries export their taxes to the capital-exporting countries (Pehlivan, Öz, 2019, p. 109). As a result of this, it becomes apparent that the recipient of deductions made by importing countries from limited taxpayers is not foreign investors but rather the capital-exporting country.

Taking these factors into account, it can be suggested that for countries with significant capital markets and acting as capital exporters, applying the credit method would be more favorable in the case of capital flight. On the other hand, for smaller capital-exporting countries, providing exemptions for gains obtained by multinational corporations from abroad might be more advantageous (Batırel, 1990, p. 47).

While the credit method can be applied unilaterally at the national level, it is also widely applied in international tax treaties. In international tax treaties, the credit method is applied in two different ways: the full credit method and the ordinary (partial) credit method. In the full credit method, the tax paid abroad (in the source country) can be deducted from the total tax calculated on both domestic and foreign income in the residence country. In the ordinary credit method, the tax paid abroad (in the source country) is only eligible for a reduction equal to the portion attributable to foreign-source income in the total income calculated on both domestic and foreign income in the residence country (Yaltı Soydan, 1995, p. 259). When ordinary credit is involved, the country applying the credit method can deduct an amount equal to the tax collected by the country adopting the source principle, which taxes worldwide income, against the tax calculated on a worldwide income basis. Conversely, in the case of full credit, the country adopting the residence principle, which taxes income derived globally, can offset an amount equal to the tax calculated on the income earned worldwide. (Molenaar, 2006, p. 175).

In other words, according to the full or unlimited credit method, the entire amount of tax paid on income earned in the country adopting the source principle is deducted from the tax liability calculated in the country adopting the residence principle. However, under the ordinary or limited credit method, only a portion of the tax liability calculated on all sources of income earned in the country adopting the source principle is deducted from the tax liability calculated in the country adopting the residence principle (Öz ve Çavdar, 2012, p. 57).

While the credit method is considered the most successful method to avoid double taxation, its complex structure can pose challenges for taxpayers and governments in practice. Such challenges can be counted as calculating the tax base of foreign-source income, determining the tax rates applied to the base, and obtaining information about taxes paid in a foreign country. Therefore, for the application of the credit method, there needs to be collaboration and information sharing between the tax administrations of different countries. Additionally, the credit method has faced criticism for eliminating the impact of tax incentives such as tax exemptions and rate reductions applied in the source country (Yaltı Soydan, 1995, p. 261).

In conclusion, in the credit method, the tax paid in a foreign country is deducted from the tax payable in the domestic country. Therefore, the fundamental issue with this method is that if the tax paid in the foreign country is higher than the tax paid domestically, it may not be fully credited. As a result, investments made in a foreign country can become overcostly. This method is known as the primary approach in the tax systems of many countries, including the United States, to prevent international double taxation.

Effective operation of the credit method requires legal and technical regulations. Such adjustments are necessary, particularly in states with low tax rates. Otherwise, taxpayers may attempt to avoid taxes within their own country by shifting their income to such states. (Erdem, 1999, p. 160)

2.1.2. Tax Sparing Method

The Tax Sparing Method involves the use of lower tax rates instead of the existing tax rate when calculating tax on a portion or the entirety of income. Tax sparing occurs when a source country provides tax incentives to foreign investors, leading to a lowered or zero tax liability in the investor's income of the source country compared to what would have been payable in source country. (Yaltı Soydan, 1995, p. 262). Considering the existence of varying tax rates for different types of taxes across countries, this method is regarded insufficient in preventing double taxation. The Tax Sparing Method generally partially prevents double taxation. However, due to the diverse nature of taxes collected and applied tax rates by states, the method's success in eliminating international double taxation depends largely on chance (Soydan, 1994, p. 6).

Without doubt, there is no incidence of double taxation as the foreign source income of the investor is either taxed solely in the country of residence or subject to a reduced rate in the country of source, with country of residence offering a corresponding tax credit. However, the effective taxation of this income at the tax rate of the country of residence essentially cancels out the impact of the tax incentive provided by the source country.

(Holmes, 2014, 109) “Thus, tax sparing cannot be derived from the traditional objective of double tax treaties” (Viherkenttä 1991 p. 141).

This measure can be unilaterally implemented by states or reciprocally applied (Egeli, Özcan, 2014, p. 80). States have the flexibility to reduce tax rates applied to all or part of the taxpayer's income.

We believe it would make sense to give an example from Holmes[1] (2014, pp. 109-111):

A citizen residing in the United Kingdom generates earnings of 1,000 from China, representing their sole income for the fiscal year. To simplify, let's consider a tax rate of 30% in both the United Kingdom and China. The taxpayer's tax situation in each is as follows:

China	
Income sourced in China	1,000
Tax payable in China	300
United Kingdom	
Worldwide income	1,000
Tax on worldwide income (30% × 1,000)	300
Less: foreign tax credit	(300)
Tax payable in the United Kingdom	0
Total tax payable (all to China)	300

If the investor had invested in a project that met the criteria for China's previous 10-year tax holiday incentive program. The taxpayer's updated tax positions in each country are as follows:

China	
Income sourced in China	1,000
Tax payable in China	0
United Kingdom	
Worldwide income	1,000
Tax on worldwide income (30% × 1,000)	300
Less: foreign tax credit	(0)
Tax payable in the United Kingdom	300
Total tax payable (now all to the United Kingdom)	300

Hence, utilizing the foreign tax credit system, despite the tax holiday extended by China, the taxpayer ends up paying an equivalent total tax amount. The tax holiday regime in China has resulted in China forgoing the 300 in taxes, but these funds do not benefit the investor; rather, they accrue to the UK Revenue. (Holmes, 109-110)

[1] The figures and calculations were taken from the cited author.

Tax sparing credits are not provided for in either the OECD Model or the UN Model Tax Convention. The United States strongly opposes tax sparing credits and, therefore, they do not appear in the U.S. Model Double Taxation Treaty or in any of its bilateral double taxation treaties. On the other hand, some developing countries do not enter into double taxation treaties with developed countries unless the latter offer tax sparing credits. Obviously, there is no need for tax sparing credits if the investor's country of residence uses the exemption method of double tax relief. (Holmes, 2014, 111)

2.1.3. Exemption Method

The exemption method is a relief method in which the income derived from domestic activities of a taxpayer in the home country is subject to taxation, while the income obtained from foreign activities is exempt from taxation (Kızılgül, 2019, p. 46). In other words, in this method, there may be a situation where both the residence state and the source state waive their taxing authority (Öz, 2005, p. 32).

If a country adopts the residence principle and applies the exemption method, it means that it has accepted the taxing authority of the source country in taxing foreign income and has waived the worldwide taxation feature of the residence principle. Therefore, the country adopting the residence principle grants the authority to tax the taxpayer to the country adopting the source principle according to its own tax laws and rates (Molenaar, 2006, p. 173). If the residence state abandons its taxing authority, the investment will be subject to taxation in the country where it is made (Berkay, Armağan, 2011, p. 92). Therefore, if the tax in the source country is lower than the tax in the residence country, the most suitable method for the taxpayer is the exemption method.

If a country adopts the source principle and applies the exemption method, income earned in foreign countries is entirely excluded from the calculation. In other words, taxes are calculated only on the resources owned, and income and wealth elements in foreign countries are not taken into account (Karaldı, 2015, p. 31).

If we were to provide an example of the application of the exemption method, let us assume that Italy and Spain apply the exemption method to prevent double taxation. Suppose an individual residing in Italy, subject to income tax, generates 200,000 EUR from ventures in Spain and 100,000 EUR from freelance activities in Italy. Assuming an income tax rate of 50% in Italy and 30% in Spain, according to the exemption method, the residence country should waive taxation on the income elements already taxed in the source country.

Accordingly, the income of 200,000 EUR generated by the individual through investments in Spain should be taxed according to the conditions of the state where the investment was made. In this case, the individual would need to pay tax on the income earned in Spain, calculated as 200,000 x 30% = 60,000 EUR. Following the exemption method, the individual should exempt the 60,000 EUR tax paid in Spain from taxation in their residence country, Italy. Therefore, in Italy, the individual would only be liable for tax on the income of 100,000 EUR derived from freelance activities, resulting in a tax payment of 100,000 x 50% = 50,000 EUR.

In the exemption method, international double taxation arising from residence is completely avoidable because only one country fully exercises its taxing authority. The exemption method provides ease of application for tax authorities and is effective in preventing double taxation. However, when a progressive rate schedule is applied, it becomes complex due to the necessity to investigate foreign-sourced income. This method can lead to tax injustice within the country as a taxpayer exempt from tax on foreign income in the country of residence may be in a more advantageous position compared to another fully taxable resident with an equivalent domestic income. (Erdem, 1999, p. 160).

While this method generally provides a stable income for countries with significant investments abroad, it also promotes an increase in capital flow to debtor countries. Consequently, this method emerges as a way of encouraging the development of less developed countries (Wang, 1945, p. 74). On the other hand, domestic investors, through this method, channel their investments to foreign countries and are not required to pay taxes in the domestic country for the taxes paid in the foreign country. This situation particularly encourages investing in countries with very low tax rates, leading to harmful tax competition. (Bayar, 2006 p.20.)

According to William, the exemption method provides a significant competitive advantage for domestic companies in their foreign activities. This method ensures that domestic companies can continue their operations in foreign countries under equal conditions. Globally, the use of the exemption method by domestic companies for activities through foreign investments weakens the fundamental principles of taxation worldwide, as these companies enhance their competitiveness through foreign investments (William, 2007, p. 353).

2.1.4. Deduction Method

In the tax deduction method, it can be stated that the taxes paid in the source country on the same income or wealth elements are deducted from the tax base in the country of residence (Kızılgül, 2019, p. 49). In other words, the taxes paid abroad are deducted not from the domestic tax obligation but from the total tax base calculated domestically. Therefore, in the tax deduction method, these taxes paid abroad are considered as a cost element related to foreign investment and are accepted as deductible expenses (Yılmaz, 2019, p. 55). As a result, the deduction of foreign taxes from the tax base does not mitigate international double taxation but rather lessens its impact (Edrey, Jeffrey, 1991, p. 111).

In cases where many countries cannot apply any method, meaning when international double taxation cannot be resolved through bilateral tax agreements, then they decide to apply the deduction method as a last resort. However, some countries implement the tax credit method in any situation, giving it a wider scope of application. For instance, individuals in the United States subject to unlimited tax liability for their entire global income have the option to waive claiming a tax credit for foreign taxes. Instead, they can choose to deduct the foreign tax as a business expense, significantly reducing the taxable base. (Molenaar, 2006, p. 195)

For Example: A taxpayer residing in Turkey earns an annual income of 75,000 EUR in Turkey and 40,000 EUR in Germany. While the tax rate in Turkey is 20%, in Germany, it is 25%. If the tax deduction method is applied in Turkey, the tax amount this taxpayer will pay in Turkey is calculated as follows:

Tax to be paid in Germany: 40,000 * 0.25 = 10,000 EUR

Tax to be paid in Turkey: 115,000 (75,000 + 40,000) * 0.20 = 23,000 EUR

After the deduction method, the taxpayer will pay the following tax amount in Turkey:

105,000 (115,000 - 10,000) * 0.20 = 21,000 EUR .

In conclusion, countries generally choose to prevent international double taxation through exemption or credit methods. Even in the absence of tax treaties, states refrain from using the deduction method. At this stage, countries are reluctant to apply the tax credit method, as they refer that they are bound to the exemption or credit norm (Avi-Yonah, 2004, p. 500). Therefore, as exemption and credit methods have become integral parts of international law in the avoidance of international double taxation.

Due to the involvement of multiple states in the taxation authority and variations in economic conditions and tax policies among states, national (unilateral) measures taken by states fall short as a solution point. Therefore, resorting to international measures has become inevitable for the resolution of this issue.

2.1.5. Comparison of the Methods of Relief

A company resident in country R has income of 100,000 EUR from its commercial activities in country S. The mentioned company does not have any income-generating activities in country R. In this case, country S will tax the company according to the source principle, while country R will use the residence principle for taxation, leading to double taxation. It is known that the corporate tax rate is 25% in country R and 20% in country S. As the source country, country S always collects 20,000 EUR in taxes. (100,000 x 20%)

- In the exemption method, since the income earned in country S is not taxed at all in country R, the total tax burden is calculated as 20,000 EUR.
- In the credit method, the 20,000 EUR paid by the company in country S is subtracted from the tax amount it would normally have to pay in country R, which is 25,000 EUR. Therefore, the company pays only 5,000 EUR in taxes in country R. (25,000 - 20,000 = 5,000)
- In the deduction method, the 20,000 EUR tax paid by the company in country S is deducted from the tax base in country R. Therefore, the company is required to pay tax on 80,000 EUR at a rate of 25% in country R. (80,000 x 25% = 20,000)
- In the tax sparing method, assuming that country R applies a tax rate of 10% for foreign commercial gains instead of 25%, the company pays 10,000 EUR in taxes in country R. (100,000 x 10% = 10,000)

Table 2.1: The impact of national methods on double taxation

	Tax Paid		**Total Tax Liability (A+B)**
	Country A	**Country B**	
Corporate Income (1)	100.000	100.000	
Tax Rate (2)	25%	20%	
Deducted Tax Rate	10%	0	
Double Taxation (1 x 2)	25.000	20.000	45.000
Exemption Method	0	20.000	20.000
Credit Method	5.000	20.000	25.000
Deduction Method	20.000	20.000	40.000
Tax Sparing Method	10.000	20.000	30.000

As seen in Table 2.1, the most advantageous situation for the taxpayer is the exemption method, while the least efficient method in preventing double taxation is the deduction method.

Another example here is given. Table 4 illustrates how the income tax burden of an individual residing in country B will change when deduction, credit, and exemption methods are applied, assuming that single-rate Income Tax tariffs are applied in countries A and B. The (Uluatam and Methibay, 2001, p. 65).

Table 4: Comparison of Unilateral Methods for Limiting Double Taxation (Uluatam, Methibay, 2001)

Countries	**Income**	**Tax Rate**	**Tax Paid (Deduction Method)**	**Tax Paid (Credit Method)**	**Tax Paid (Exemption Method)**
Country A	1000	0,2	200	200	200
Country B	2000	0,3	840	700	600
Total Tax			**1040**	**900**	**800**

Here, the table below has been prepared based on methods to prevent double taxation, assuming an income of 1,000,000 EUR earned abroad, a tax rate of 45% in the residence country A, and 30% in the host country B where the subsidiary is located (Öz, 2005, p. 32).

Table 5: Methods for Preventing Double Taxation

	(A) Residence Country	(B) Source Country	Total Tax Liability	Net Profit
Total Income	1.000.000	1.000.000		
Tax Rate	45%	30%		
1. Exemption Method	0	300	300	700
2. No Exemption Applied	450	300	750	250
3. Credit Method	150	300	450	550
4. Deduction Method	315	300	615	385
5. Tax Haven	450	0	450	550
6. Tax Sparing Method	150	0	150	850

In Table 5, the application of certain tools and methods used to prevent double taxation is outlined, showing how the total tax burden and net earnings of taxpayers would change. As observed, among the methods employed to prevent double taxation, the tax sparing approach stands out as privileged. The tax regulations of the residence country play a decisive role in foreign investments and have a significant impact on investment decisions (İnce, 2013, p. 9).

2.2. International (Bilateral) Regulations

Differences in states' tax policies and the diversity of economic conditions have rendered unilateral national methods developed by states insufficient for preventing double taxation. Hence, the necessity of using international methods has emerged for the solution of this problem. International methods and tools used to prevent double taxation are based on agreements made between two or more states (Egeli and Özcan, 2014, p. 80).

Countries can implement one of these four methods of double taxation relief. These are full exemption, exemption with progressivity; a full tax credit or ordinary tax credit. (Sarmento, 2023, p. 248)

2.2.1. Credit Method

In this method, both the source state and the residence state impose taxes, and later, the tax paid in the source state is deducted from the calculated tax in the residence state. The taxes subject to this method are determined through tax agreements between states (Başak, 2005c, p. 59). Under this method, the tax burden on investments made abroad will be the same as the tax burden in the residence country as long as it does not exceed the tax rate in the source country, which is the domestic country tax rate (Şenyüz, 2005, p. 14).

By implementing this method, countries can control the flow of goods to states with low tax rates and find the opportunity to expand their tax jurisdiction. In this method, the country where the investor resides, within certain legal constraints, allows for the offset of the tax paid abroad as if the tax were collected by itself.

If the tax rate in the foreign country is less than the tax rate in the domestic country, the portion of the tax applied in the domestic country exceeding the tax applied abroad will be paid by the investor in their own country. In the opposite case, if the tax rate in the foreign country is higher, there is no need for the investor to pay tax in their own country. The actual tax burden will be determined by the party with the higher tax rates from these two countries (Çubukçu, 2006, p. 33).

An example can be given here. Enterprise K, a taxpayer that is resident in Turkey, engaged in business activities in the United States, generates income of 100 EUR from those activities. Due to its commercial activities in Turkey, earns 50 EUR, totaling 150 EUR. The deduction of the 36 EUR tax paid in the U.S. on the income of 100 EUR, from the income tax in Turkey should be as illustrated in the table below:

Table 2: Example of the Credit Method for Tax Paid in Foreign Countries

Income earned in the U.S.:	100 EUR
Proportion of income earned in the U.S. to total income:	67%
Tax paid in the U.S. (36%):	36 EUR
Income earned in Turkey:	50 EUR
Proportion of income earned in Turkey to total income:	33%
Total income to be declared in Turkey:	150 EUR
Tax to be paid in Turkey (Assuming a tax rate of 20%):	30 EUR
Portion of Turkish income tax attributable to income earned in the U.S. (30 x 67%):	20.1 EUR
Tax to be paid in Turkey after offset (30 - 20.1):	9.9 EUR

As shown in Table 2, it is evident that the entire 36 EUR of tax paid in the U.S. cannot be deducted. Despite the tax paid in the U.S. being 36 EUR due to income earned in that country, only 20.1 EUR of this tax can be deducted in Turkey against the total income tax calculated on the Turkish income.

2.2.1.1. Full Credit – Ordinary Credit Method

The credit method can be applied unilaterally at the national level, as well as being widely used in international tax treaties. In international tax treaties, the credit method is applied in two different ways: full credit method and ordinary (partial) credit method.

In the full credit method, the tax paid in the foreign country (source country) can be deducted from the total tax calculated on both domestic and foreign income in the residence country. In the ordinary credit method, on the other hand, the tax paid in the foreign country (source country) can only be deducted up to the portion related to the foreign-sourced income from the total tax calculated on both domestic and foreign income in the residence country (Yaltı Soydan, 1995, p. 259).

In the ordinary credit method, to be more specific, the residence state permits a deduction of the foreign-source tax from the tax calculated on the worldwide income, but this deduction amount cannot be more than the proportion of tax that would be attributable to the income from State S. This limitation is called maximum deduction (Molenaar, 2006, p. 176). In other words, in the ordinary credit method, if the tax paid in the source country exceeds the portion related to the foreign-sourced income in the residence country, this excess amount cannot be deducted.

Below is an example illustrating the full credit and ordinary credit methods.

An international double taxation agreement has been signed between countries R and S. An individual residing in country R earns a total annual income of 100,000, with 70,000 in country R and 30,000 in country S. Country R follows the residence principle, and country S follows the source principle. The tax rates are standard, set at 20% in country R and 25% in country S. When applying both full credit and ordinary credit methods in country R, the tax amount the individual will pay in country R is calculated as follows:

→ Tax calculated in country R: 100,000 * 0.20 = 20,000 (Of this, 30,000 * 0.20 = 6,000 belongs to the tax calculated on income earned in country S.)

→ Tax paid in country S: 30,000 * 0.25 = 7,500

If the full credit method is applied, the individual's tax amount in country R will be <u>12,500</u> (20,000 - 7,500),

While in the case of the ordinary credit method, the individual's tax amount in country R will be <u>14,000</u> (20,000 - 6,000).

This is because, in the ordinary credit method, the 1,500 portion of the tax paid in country S cannot be deducted beyond the portion related to the income earned in country S (6,000). In other words, according to this example, the amount that can be deducted under the ordinary credit method is limited to 6,000.

2.2.2. Exemption Method

Exemption method involves that the income is to be excluded from the tax base of the State of residence. (Vogel 1997, p. 1179.) 221. It is regarded as one of the most successful measures among those used to prevent double taxation and the most suitable for tax technique. (Başak, 2005c, p. 67).

In bilateral tax treaties, this method is applied as one of the treaty-partner states waives its authority to tax certain elements of income and wealth. The amounts of income or wealth obtained in the state that is a party to the agreement can be subject to taxation in the other participating state according to the relevant treaty provisions. In this method, one of the states can exempt income obtained from foreign countries either according to its own legislation or based on bilateral agreements. In other words, in the exemption method, the residence state excludes elements subject to tax in the source state from the taxation process. Additionally, in both cases, the tax paid in the source state will not exceed the tax amount determined according to the tax laws existing in the residence state (Öz, Çavdar, 2012, p. 57).

Without any doubt, with this method, there is no need for any calculations to prevent double taxation. The income earned abroad is directly exempted from taxation, preventing additional taxation by the resident country on this income source.

Through the exemption method, an approach to the source principle is made, by abandoning the residence principle-based taxation. The aim is to exclude the income generated by resident investors from their activities in foreign countries from the scope of taxation. This is done to ensure that they do not bear an additional tax burden in the source country where they operate. In this way, resident investors in the country gain the opportunity to compete on equal tax terms in the host country markets with their competitors, that are the local investors. On the other hand, especially in countries with low tax rates, a differentiation in terms of the tax burden is created in favor of enterpreneurs between entrepreneurs investing abroad and investors who are investing domestically. In other words, resident investors are encouraged to invest in countries where the level of taxation is relatively low. This method, which particularly aims to promote capital export, is observed to be employed with the intention of attracting especially the holding companies, characterized as regional headquarters of multinational corporations, to the country (Sarı, 2012, p. 49).

To give you an example, let us assume that in Italy, a tax rate of 0%, instead of the regular tax rate of 36%, is applied to taxpayers engaged in commercial activities to promote the economic development of certain regions. Let's assume that there is an agreement related to the exemption method between Turkey and Italy. In the case of a Turkish resident company engaging in commercial activities in these regions through a branch in Italy, according to the relevant article of the agreement between the two states, a branch is considered to be formed in Italy. Therefore, assuming that the taxation of the income obtained in this way will also be carried out in Italy under the agreement:

Table 3: Example of Applying the Exemption Method

Income earned in Italy:	**100 EUR**	Ratio of income earned in Turkey to total income:	**33%**
Tax amount that should be paid in Italy under normal conditions:	**36 EUR**	Declared income in Turkey:	**150 EUR**
Tax amount paid in Italy due to incentives:	**0 EUR**	Tax amount to be paid in Turkey on total earnings (30% corporate tax):	**45 EUR**
Share of income earned in Italy in total income:	**67%**	Portion of the Turkish corporate tax amount attributable to income earned in Italy (45x67%):	**30.15 EUR**
Income earned in Turkey:	**50 EUR**	Tax amount to be paid in Turkey after offset (45-30.15):	**14.85 EUR**

As seen in the example above, the tax amount levied at a low rate by the Italian Tax Administration for the purpose of expanding investments in certain regions will be beneficial not for Turkish public revenues but for Turkish companies investing in these regions.

The first benefit of the method is that the taxpayer deals with only one state due to the tax to be paid through this method. The tax administration also has no obligation for any research other than determining the exemption amount. The other and most significant advantage of the method is that the advantages provided by tax incentives in the source country are not eliminated. It creates tax equality and competitive opportunities for foreign investors in the source country. On the other hand, one of the drawbacks of the exemption method is deviating from the principle of taxing based on financial capacity in the residence country, in favor of those earning income in foreign countries. This situation becomes apparent when foreign earnings are not included in the tax base. The second disadvantage related to the method is directing investments towards states with lower tax rates. In other words, it hinders the free movement of capital, individuals, and services (Kalaycıoğlu, 2017, p. 2).

2.2.2.1. Full Exemption Method - Exemption with Progression Method

Within this context, there are two types of exemption methods. The first is the full exemption method, and the second is the exemption with progression method. In the full exemption method, one of the countries abandons all taxing powers and allows taxation based on the tax rates of the other country. (Molenaar, 2006, p. 175). In other words, income elements that can be taxed in the source country are not taken into account in the residence country, and these untaxed income elements are not considered in determining the tax rate to be applied to the tax base. (Yaltı Soydan, 1995, p. 256)

In the exemption with progression method, the amount of tax paid in other countries is exempted, and taxation is carried out on the remaining amount. The remaining amount is determined as the amount calculated over the income derived from domestic sources within the country (Molenaar, 2006, p. 175). In this sense, the amount of income elements that can be taxed in the source country is not included in the tax base in the residence country, but it is considered in determining the tax rate to be applied to the tax base. (Yaltı Soydan, 1995, p. 256)

Below is an example illustrating the full exemption and exemption with progression methods:

A Double taxation treaty has been signed between Country R and Country S, and an individual residing in Country R earns a total annual income of 100,000, with 80,000 in Country R and 20,000 in Country S. Country R follows the residence principle, while Country S follows the source principle. The tax rates in Country R are progressive, set at 30% for incomes up to 80,000 and 35% for incomes exceeding 80,000. In Country S, the tax rate is fixed at 20%. When applying both the full exemption and exemption with progression methods in Country R, the calculation of the tax amount the individual would pay in Country R is as follows:

→ **Full Exemption Method**: When this method is applied, the income earned in Country S (20,000) will be exempted from tax, and tax will be calculated at a rate of 30% on the income exceeding 80,000. In this case, the tax payable in Country R would be: 80,000 * 0.30 = 24,000.

→ **Exemption with Progression Method**: If this method is applied instead, the income earned in Country S (20,000) will not be included in the tax base, but the tax rate applied to the tax base will be considered when determining the tax rate, which is the tax rate corresponding to 80,000 + 20,000 = 100,000 in the tax tariff. In this case, the tax payable in Country R would be: 80,000 * 0.35 = 28,000.

The application of the exemption method is advantageous for the taxpayer when the tax rate in the source country is lower than the tax rate in the residence country since the total tax burden will be the lowest. However, from the perspective of the tax administration in the residence country, it will be more costly as it involves giving up more tax revenue.

To sum up all, it can be concluded that by employing the credit method, a developed country has the potential to increase its tax revenue through the treaty, as the tax burden in the developing nation reduces. However, should developed countries opt to grant tax exemptions to their foreign investors for profits generated in developing countries, either through the international treaties or through domestic tax laws, it could undermine the developing countries' capacity to impose taxes on those investors. This stems from the fact that when investors face no additional tax burden on their earnings beyond what they earn in the source state, they are more inclined to adopt tax competition among potential host states or attempt to avoid tax payments in those states (Hearson, 2018, p.236).

2.2.3. Bilateral or Multilateral Tax Treaties

Another measure taken by states to prevent double taxation is the signing of bilateral or multilateral tax treaties. States entering into these agreements generally agree to limit the absolute right to impose taxes. The primary purpose of signing these agreements between nations is to prevent double taxation.

Through international tax treaties, the allocation of powers between states regarding taxation, i.e., determining which state will levy taxes based on which tax laws, is established. The main aim is to prevent double taxation arising from the exercise of taxation powers by multiple states. (Şenyüz, 2005, p. 13). These treaties formally determine which country will tax an item or taxpayer and/or whether exemptions of income or credits for tax paid will be granted in the other jurisdiction (Holmes, 2014. p.103-104).

While efforts to prevent double taxation are largely addressed through bilateral agreements, there are also multilateral agreements, although not as common, aimed at solving this issue. States with similar characteristics in various aspects have attempted to address the problem of double taxation more regionally by entering into multilateral agreements (Güngör, 1987, p. 30).

2.2.3.1. Bilateral Tax Treaties

An international treaty is essentially a contract among independent nations, relying on the honour and the interests of the governments forming the parties to the treaty for the implementation of its provisions (McIntyre, 2010, p. 8). Tax treaties indicate whether tax authorities will apply their domestic law to foreign-related financial events. In this respect, tax treaties carry both the nature of an international treaty and an internal legal rule (Yaltı

Soydan, 1995, p. 65). For taxation to be applicable, there must be a substantive legal rule behind conflict-of-law rules; in other words, the authority to tax comes from domestic law (Rust, 2007, p. 267). Consequently, if there is a possibility of a state party to a tax treaty having an authority that does not exist in its domestic law, it is not possible for the relevant state to apply this competence in its domestic law (Işık, 2014, p. 61)

Although the primary goal of a Double taxation treaty is to promote international trade and investment by mitigating the risk of double taxation arising from the overlapping tax jurisdictions of two countries (Kobetsky, 2011), bilateral tax treaties serve not only to prevent and eliminate international double taxation but also to achieve other objectives. When states consider model tax treaties while entering into bilateral tax agreements; tax types, tax matters, tax base, and taxation principles are aligned with international standards. This, in return, brings states' tax systems closer to each other (Yaltı Soydan, 1995, p. 31). Moreover, provisions involving cooperation between tax administrations and the sharing of information regarding taxpayers' situations contribute to preventing international tax evasion and tax avoidance (Başok, 2016, p. 37).

Bilateral agreements aim to eliminate or minimize international double taxation by imposing limitations on tax obligations of the Contracting States themselves, particularly the state where the income originates. Additionally, they can force the country of residence to either provide an exemption or offer a tax credit for the taxes paid in the source state (Sarmiento, 2023, p. 247).

In this context, it is possible to define international tax treaties as agreements specifically designed by states to address and resolve the issue of international double taxation as a priority (Carroll, 1978, p. 51). Through agreements aimed at preventing international double taxation, countries desire to clarify the financial situations of taxpayers engaged in commercial, industrial, financial, or other activities, in each member country with the goal of establishing standards (Vehovec, 2007, p. 27).

2.2.3.2. Multilateral Tax Treaties

A multilateral tax agreement is regarded as official documents endorsed by multiple states, outlining the limits of tax jurisdiction for the participating states and governing various aspects related to taxation(Kızılgül, 2019, p. 75). States sharing similar economic structures and tax systems often seek to address the issue of international double taxation by engaging in regional-scale multilateral tax agreements (Egeli, Özcan, 2014, p. 81).

As an example of multilateral tax agreements, the tax information exchange agreement signed between Iceland, Finland, Norway, Sweden, and Denmark can be given. Due to the similarity of tax legislation, administrative procedures, and work cultures, it is stated that this agreement is effectively implemented and serves as a good example of multilateral tax agreements (Valkama, 2013, p. 205). Furthermore, as an example of efforts to prevent international double taxation through multilateral agreements, the Model Tax Treaty signed in 1971 by five South American countries under the name The Double Taxation Convention of the ANDEAN Group, also known as the Andean Pact. and the CARICOM Tax Agreement signed by Caribbean countries in 1973 are also highlighted (Rohatgi, 2005, p.75).

Theoretically, multilateral agreement is a concept that can surely be implemented. However, structurally, they are more complex compared to bilateral agreements. Reaching consensus among three or more states on economic and legal interests is more challenging. Factors such as differences in countries' tax legislations, gaps in their levels of development, diverse positions in the world economy and politics, and variations in political, economic, and fiscal policies make it challenging to establish multilateral tax agreements among more than two countries. Moreover, updating or terminating such agreements is also more difficult when compared to bilateral agreements. (Yaltı Soydan, 1995, p 34). Due to these reasons, the practical implementation of multilateral agreements is not commonly witnessed.

2.3. Application of Turkey

In the Turkish tax regulations, certain measures and tools have been included to prevent double taxation. It can be said that the related provisions are mostly formed with a restrictive nature in terms of limiting the taxing authority.

In general, in Turkey; for income tax, for the taxation based on residence principle, the credit method is applied; however for taxation based on the nationality principle the exemption method is applied. For corporate income tax, the credit method is used. The issue of international double taxation in Turkey is generally resolved by deducting taxes paid in foreign countries from taxes to be paid in Turkey, subject to certain conditions. Additionally, under certain conditions, exemptions are also provided in many taxes (Erginay, 2003, p. 23). In order to prevent the double taxation of income and profit elements obtained in both countries, the legislator has regulated the offset process in both the Income

Tax Law (Article 123) and the Corporate Income Tax Law (Article 33) under the title "Deduction of taxes paid abroad".[2]

2.3.1. In Terms of Income Tax

In terms of income tax application, the Turkish Tax System adopts a method based on the combination of residence, source, and nationality principles. The Turkish Income Tax Law adopts the residence and nationality principles on the basis of full liability, while accepting the source principle in the case of limited liability. (Şenyüz, 2005, p. 24-25) In this sense, for individuals to be considered fully taxable under this law, meaning they are taxed on their entire income and earnings both within and outside of Turkey, they must be residents in Turkey and be subject to the nationality principle under certain conditions (Öncel, *et al.*, 2010, p. 256).

In the residence-based credit method, the accepted credit method is the ordinary credit method. In taxation based on nationality, however, the full exemption method is applied. (Öncel, *et al.*, 2010, p. 261). On the other hand, non-resident individuals in Turkey, in other words limited taxpayers, are only subject to taxation on income earned within Turkey. Therefore, the source principle is considered in the case of limited liability.

2.3.2. In Terms of Corporate Tax

In corporate tax practices in Turkey, just as in income tax practices, the principle of deducting taxes paid in foreign countries, in other words, the credit method has been accepted to prevent double taxation. The preferred credit method is the ordinary credit method, similar to income tax (Yaltı Soydan, 1995, p. 27).

In terms of Corporate Income Tax application, for full taxpayers, the personality principle based on legal headquarter or place of effective management is adopted, while the source principle is adopted for limited taxpayers (Şenyüz, 2005, p. 24). In this sense, in determining full liability in corporate tax application, the criterion of 'being resident in Turkey' in income tax is replaced by the criterion of "legal headquarter or place of effective management of the corporation being in Turkey" (Kızılgül, 2019, p. 53). In this regard, a company with one of its legal headquarters or place of effective management within the

[2] https://www.vergidegundem.com/documents/10156/177596/mayis2011english-translation.pdf

borders of Turkey, is recognized as fully liable according to Corporate Tax Law provisions (Ildır, 1999, p. 83)."

In other words, if a foreign company with a multinational structure operates within the borders of Turkey by either;

a. Establishing a corporation in which it owns the entire capital,

b. Establishing a joint venture with a Turkish partner, or

c. Becoming a partner in an existing Turkish company, it will be subject to full liability.

As a result of these, in terms of full liability, there is no difference in the responsibilities and rights of a Turkish company operating under the same conditions as foreign companies before tax laws. If these elements are not present for that company in Turkey, the company will be subject to limited liability, meaning it will be taxed only on the income elements it earns in Turkey.

2.4. The Comparison and Evaluation of Unilateral and Bilateral Measures of International Double Taxation

2.4.1. Comparison of the Measures

Their comparison will be done through an example given by **Molenaar (pp 174-176):**

“These methods have different results, as will be shown by the following example of two different cases, I and II.

(The figures for this explanation have been taken from the official Commentary on Article 23 of the OECD Model Convention.)

– an artiste earns 80,000 at home in State R(esidence) and 20,000 abroad in State S(ource) = worldwide income of 100,000;

– in State R the tax rates are progressive, namely 35% (average) on an income of 100,000 (= 35,000) and 30% (average) on an income of 80,000 (= 24,000); and

– in State S the tax rate is either 20% (in case I) or 40% (in case II), leading to 4,000 or 8,000 source tax

Without any relief for double taxation, the total initial tax burden would be

	Case I	Case II
tax in State R, 35% x 100,000 =	35,000	35,000
+ tax in State S	4,000	8,000
total taxes	39,000	43,000

Full exemption: With the "full exemption", the home country, State R, simply omits the foreign income from its own taxation and only imposes tax on the domestic income of 80,000, at 30%:

	Case I	Case II
tax in State R, 30% x 80,000 =	24,000	24,000
+ tax in State S	4,000	8,000
total taxes	28,000	32,000
tax relief in State R: 35,000 – 24,000 =	*11,000*	*11,000*

Exemption with progression: With the "exemption with progression", the home country, State R, takes into account the exempted foreign income when calculating the amount of tax on the remaining, domestic income. Therefore, domestic income is taxed at the tax rate for worldwide income, i.e. 35%:

	Case I	Case II
tax in State R, 35% x 80,000 =	28,000	28,000
+ tax in State S	4,000	8,000
total taxes	32,000	36,000
tax relief in State R: 35,000 – 28,000 =	*7,000*	*7,000*

Full credit: With the "full credit", the home country, State R, simply allows the deduction of the foreign-source tax from the tax calculated on worldwide income:

	Case I	Case II
tax in State R, 35% x 100,000 =	35,000	35,000
– full tax credit	– 4,000	– 8,000
total tax in State R	31,000	27,000
+ tax in State S	4,000	8,000
total taxes	35,000	35,000
tax relief in State R (full tax credit) =	*4,000*	*8,000*

Ordinary credit: With the "ordinary credit", the home country, State R, also allows a deduction of the foreign-source tax from the tax calculated on the worldwide income, but not more than the proportion of tax that would be attributable to the income from State S (maximum deduction). This limitation to the average tax rate is a maximum of 35% x 20,000 = 7,000 in this example and applies in Case II

	Case I	Case II
tax in State R, 35% x 100,000 =	35,000	35,000
– ordinary tax credit	– 4,000	– 7,000 (max.)
total tax in State R	31,000	28,000
+ tax in State S	4,000	8,000
total taxes	35,000	36,000
tax relief in State R (limited tax credit) =	*4,000*	*7,000 (max.)*

Summary of the figures: These figures can be summarized as follows:

– For Case I:

	Relief State R	Tax State S	Result
full exemption	11,000	– 4,000	= 7,000
exemption with progression	7,000	– 4,000	= 3,000
full credit	4,000	– 4,000	= 0
ordinary credit	4,000	– 4,000	= 0

– For Case II:

	Relief State R	Tax State S	Result
full exemption	11,000	– 8,000	= 3,000
exemption with progression	7,000	– 8,000	= – 1,000
full credit	8,000	– 8,000	= 0
ordinary credit	7,000	– 8,000	= – 1,000

We can make an conclusion based on these examples as such:

The "full exemption" is applied against the highest marginal tax rate, whereas the "exemption with progression" allows for the exemption against the average tax rate in the country of residence. This distinction becomes particularly significant for a state with sharp progressive tax rates. An important advantage of the "exemption with progression" method lies in the treatment of foreign losses. These losses can be deducted against other positive income items within the domestic territory, effectively reducing the taxable income in the country of residence. This presents a more advantageous scenario compared to the "full exemption" method, where such foreign losses are included in the exemption. Among the two tax credit methods, the "full credit" results in the most favorable outcome for the taxpayer. After applying the full tax credit, the total tax burden equals the tax amount that would be due if the income were earned solely in the home country." (Molenaar, 2006, p.177)

2.4.2. Evaluation of the Measures

Many countries unilaterally implement legal regulations to prevent international double taxation and, additionally, attempt to establish relief mechanisms through the credit method to avoid the problem of international double taxation (Holmes, 2011, p. 410). Furthermore, as international commercial relations become more widespread, efforts are made to seek more effective solutions for the problem of international double taxation through international agreements (Karakoç, 2014, p. 143).

In practice, to prevent international double taxation, the method of international double taxation agreements is commonly employed among developed countries, whereas in developing countries, national unilateral methods and tools have more importance. However, due to the inadequacy of national measures in preventing double taxation, states are compelled to enter into international legal agreements to prevent and eliminate international double taxation (Yaltı Soydan, 1995, p. 28).

"The most known international double taxation conventions are those which are focused on income and capital" (Dumiter, 2023, p. 903). These agreements can be bilateral or multilateral, but bilateral agreements are much more commonly used (Öncel *et al.*, 1985, p. 70).

In this context, efforts are made internationally to prevent double taxation by countries adopting models developed for this purpose. Therefore, to standardize the international double tax agreements and transform them into a standard contract, OECD models and United Nations (UN) models have been developed (Karakoç, 2014, p. 144).

3. INTERNATIONAL DOUBLE TAXATION TREATIES – MODEL CONVENTIONS AND TURKEY MODEL

3.1. International Double Taxation Treaties

The OECD (2019) defines a double taxation treaty as such “A tax convention, or tax treaty as it is often called, is an official agreement between two countries on the administration of taxation when the domestic tax laws of the two countries apply simultaneously to a particular issue or taxpayer (e.g., when a taxpayer resident in one country derives income from sources in the other country). Tax conventions provide a means of settling on a uniform basis the most common problems that arise in the field of international double taxation.” “Internationally, it is common for states to conclude bilateral double taxation agreements in order to promote both their economic and diplomatic relations.” (Balco, 2017). Hongler (2021) states that the OECD tries to include even the non-members to their double taxation agreements. In that sense, the parties of the treaty can be either members or non-members. Even more, OECD attempts to have these treaties concluded between two non-member states.

3.1.1. The Concept of Double Taxation Treaties and Their Purposes

The primary reason for the emergence of tax treaties is as old as the history of international law, given the existence of economic, commercial, and political interest relationships. Throughout history, economic and commercial disputes have always been at the forefront of relationships that bring states together or set them apart (Başak, 2005a). In today's world, economic and commercial relationships between countries have rapidly increased; capital, technology, and labor have acquired increasingly international characteristics in terms of both scope and quality. The international mobility of factors of production as well as persons and cross-border work has led to the emergence of economic, social, and legal issues, as well as financial disputes between countries.

In this sense, these advancements have resulted in the conclusion of bilateral agreements. These agreements regulate which State has the authority to tax when a branch or subsidiary of a multinational company is located in foreign countries. (Erdős, Riczu, 2023, p. 88)

Each state, based on its sovereign rights within its national borders, has absolute taxing authority. Therefore, it is not surprising that all states tend to increase the number of taxable individuals and events, as well as expand the areas of taxation, to establish a tax system suitable for their social, political, economic, and financial conditions, demonstrating their sovereignty rights (Tokmakkaya, 1996).

International tax treaties represent a method arising from the consensus on the distribution of income derived from international economic relations and investment returns between countries. These treaties, often defined as agreements, made between two countries, that regulate the conditions for sharing tax revenues arising from activities within the respective tax jurisdictions of countries (Christians, 2005, p. 10). Through tax treaties, the determination of countries where investments will be directed is facilitated by their trust-building features. They ensure the safeguarding and clarification of the financial positions of taxpayers, providing legal certainty and stability for foreign investor taxpayers. The aim is to eliminate tax barriers to the international circulation of capital, goods, and services, thereby facilitating the flow of capital from developed to developing countries (Cenkeri, 2011, p. 168).

These agreements, signed based on international rues of law, allow the prevention of double taxation by mutually limiting the taxing powers of the contracting states. The purpose of such agreements is to mutually balance the interests of the countries party to the agreement (Pehlivan , Öz, 2011). The aim of European and international tax law is therefore not to interfere in national tax policies, but to resolve conflicts of interest arising from their conflict and overlap. (Erdős, Riczu, 2023, p. 87)

States come together to prevent international double taxation by mutually limiting their taxing powers through international agreements. This limitation can occur through bilateral agreements or through multilateral agreements (Öz, 2005, p. 38) The signing of international tax agreements imposes an obligation on the states party to the agreement to prevent double taxation, and an agreement is reached on which state will exercise the taxing authority (Yıldırım, 2010, p. 42). The initial goal of tax treaties is to prevent or reduce double taxation. (Finnerty, 2007, p. 14). Whereas, according to Irish (1974, p. 293), the main purpose of international double taxation agreements is to prevent conflicts arising from the overlap of taxation powers through bilateral or multilateral agreements, in order to enable the international transfer of capital, technology, and services. Tax treaties constitute the source of international tax law and have the function of bringing states' tax systems closer together (Yaltı Soydan, 1995, p. 31). In this respect, it can be argued that tax treaties have another function of creating law.

On the other hand, there are opposite opinions stating that in practice, the major effect of a double taxation treay signed between a developed country and a developing country is to shift the burden of tax relief from the former to the latter, rather than preventing international double taxation (Brooks, Krever, 2015). The reason of this is that developed countries are already implementing independent measures to alleviate the issue of double taxation for their investors. This is achieved either by providing tax credits for payments made abroad or, more commonly, by excluding income from foreign sources entirely from domestic taxation (Hearson, 2018, p. 236).

According to another view by Isenbergh, while tax treaties may seem to offer an advantage to certain taxpayers at first glance, their primary purpose is to ensure the distribution of tax revenue between the treasuries of the respective states (Isenbergh, 2000, p. 195).

With these being said, another objective pursued by the signing of international tax treaties is stated to be the elimination of inappropriate incentives provided to cross-border trade by preventing cross-border fiscal erosion. (McIntyre, 2010, p. 1) This is said to be achieved by ensuring cooperation between administrative units through information exchange, and thus preventing tax evasion. (Rohatgi, 2005, p. 25.) In this way, tax treaties, to some extent, provide assurance that the tax "environment" of the contracting states will remain stable. (Panayi, 2007, p. 30.) Another function of tax treaties is the engagement in development and cooperation programs with tax havens that offer, in a sense, "tax shelter" to taxpayers. Collaboration in the field of taxation, as outlined in information exchange agreements signed within the framework prepared by the OECD, plays a significant role in combating tax havens and addressing related challenges. (Kılıç, 2011, p. 163)

Tax treaties aim to address the injustice in terms of tax burden between taxpayers who earn income solely in their country of residence and those who earn income in both their country of residence and other countries. In this way, through comprehensive tax treaties, taxpayers are protected from the adverse effects of international double taxation.

3.2. Model Conventions

Model conventions can be defined as non-binding international texts that bring states together on specific issues, establishing uniform rules in terms of principles, definitions, methods, and interpretations (Yaltı Soydan, 1995, p. 43). They aim to address certain issues arising from the overlapping taxation powers of states in accordance with internationally accepted tax norms (Rohatgi, 2005, p. 68).

Model Conventions are in the nature of standard agreements, and negotiations are conducted based on draft agreements prepared for these conventions. Contracting states may add commentaries to the model or make reservations to the agreement (Şenyüz *et al.,* 2016, p. 339).

Achieving consent on a treaty text, by bringing together two countries with the aim of resolving the issue of double taxation, is a challenging task. This difficulty arises due to the diverse tax systems of the countries involved, conflicting interests, and the complexity of taxation problems. International organizations such as the OECD and UN are motivated to create model agreements for the purpose of facilitating easier and faster establishment of such consent, given the challenges involved (Yaltı Soydan 1995, p. 42).

As international trade increases, the issue of international double taxation also escalates. The primary objective of model agreements is to alleviate the burden on taxpayers caused by international double taxation. (Mulligan, 1982, p. 129)

One of the most significant benefits of Model Conventions is their ability to shorten negotiation periods and facilitate the conclusion of agreements. Model Conventions ensure legislative and operational consistency between countries. They are flexible in implementation and serve as tools that indicate ways to resolve issues. Nevertheless, Model Conventions are not binding in nature (Yaltı Soydan, 1995, p. 43). While these conventions are not legally binding, they have suggestions for the shaping of domestic financial and tax law, the development of bilateral international agreements between countries and cooperation between states on tax avoidance and double taxation. (Erdős, Riczu, 2023, p. 90)

Model conventions establish the general framework for the key provisions to be included in tax treaties, while allowing individual countries the advantage to determine the details according to their own tax systems. The aim here is to simplify the negotiation process by preventing the need to reexamine and start over with the subject, in each bilateral agreement negotiation. (Karabulut, 2014, p. 90). Without any doubt, Model Conventions will not directly align with every bilateral agreement signed by each country. As mentioned earlier, countries always have the right to make additions to Model Convention texts, taking into account their national policies. In this regard, model conventions are not rules that countries are obligated to adhere to prevent double taxation; but instead, these conventions introduce rules and methods that would benefit the countries if followed (Başak, 2005a, p.

284). Consequently, states at the negotiation table can benefit from these model agreements as guiding references without the need for extensive research.

The majority of bilateral double taxation treaties are based on the Organization for Economic Co-operation and Development (OECD) Model Tax Convention on Income and on Capital, and the United Nations (UN) Model Double Taxation Convention between Developed and Developing Countries (Arnold, 2015, p. 1). These models differ in terms of the principles underlying the allocation of taxation authority (Üstün, 2013, p. 220). The OECD Model Convention is more favorable to developed countries, while the United Nations Model, in contrast to the OECD model, places emphasis on the principle of source taxation (Covrig, 2011, p. 8).

3.2.1. The OECD Model Convention

The first model, under the name of "Draft Double Taxation Convention On Income And Capital" proposed by the the OECD Council as a recommendation to the member states, was accepted in 1963 by the OECD (Vogel, 1986, p. 11).
In the introduction part of the OECD Model Tax Convention, it is indicated explicitly that the main purpose of the Model Convention is to provide a uniform basis to solve the problems that arise in the field of international double taxation. (OECD, 2019) The aim of the OECD Model was stated by Sauvant (2009) as "creating a uniform solution to the problems of international double taxation. For the contracting parties, these agreements make it easier to invest abroad administrative burdens and facilitate the flow of goods and services between the Contracting States".

In essence, the OECD Model is originally designed to serve as a basis for tax treaties among OECD member countries. However, due to its successful implementation, this framework has become the foundation for tax treaties first among OECD countries with other nations and subsequently for agreements among non-OECD member countries themselves (Nazalı, 2008, p. 84).

The OECD Model favours the residence principle (Dauer, Krever, 2012). In the OECD Model Tax Convention, the main approach accepted is the taxation of foreign income only in the country of residence of the taxpayer (OECD, 2019). Indeed, when the residence principle is adopted, priority is given to the country where the taxpayer is a resident in taxing the principal amount. The source state, where the capital is invested and income is generated, can benefit from this to a limited extent (Tuncer, 1974, p. 137).

While significant progress has been made in eliminating international double taxation through the OECD model convention, developing countries do not benefit as much from the advantages of the model convention due to the fact that majority of the OECD members are from developed countries. When a developing country becomes a party to an agreement to prevent international double taxation, and if such an agreement is based on the OECD model, the source country relinquishes tax revenue subject to international double taxation. Therefore, such agreements to prevent international double taxation lead to unilateral consequences (Glabush-Rogers, 2009, p. 63).

In other words, when two developed countries sign a tax treaty based on the OECD model, there will be no issue. This is because there is a two-way flow of capital between the two countries. By waiving the taxation of foreign capital in their own countries, they gain the right to tax the capital belonging to their own country in foreign countries. Therefore, this situation will not pose a problem for these developed countries (Soydan 1995, p. 44). On the other hand, considering that it is nearly impossible for developing countries to export capital but they heavily import capital, if a developing country and a developed country are parties to a treaty based on the OECD model, the developing country will not be able to tax the capital it imports. Therefore, the balance will be tilted in favor of the developed country (Ildır 1999, p. 73).

The main reason for this is that the OECD Model generally allocates taxation authority to the residence country. The economic characteristic of developed countries is that they are capital exporters and labor importers. Therefore, in these countries, the residence principle is economically suitable for taxing income derived from capital directed towards foreign investment. For developing countries whose economies rely on capital imports, the source principle is more preferred in terms of subjecting foreign investments to taxation within their own countries (Başok, 2016, p. 49). Therefore, the OECD model will be advantageous for developed states.

For each provision in the OECD Model, there is a Commentary on the Model, which provides various explanations or interpretations. As this Commentary represents the shared interpretation of experts appointed by the governments of member states to the Committee on Fiscal Affairs, it is considered a crucial tool in the development of international tax law. While the Commentary is not designed to be added to tax treaties signed by member states, which are legally binding international texts on their own, it is deemed a significant instrument for the interpretation, application, and especially the resolution of disputes in the implementation of tax treaties (Yaltı Soydan, 1995, p. 45).

The OECD model is designed taking into account the economic relationships among developed countries. Therefore, if the OECD model serves as the basis for an agreement, especially between a developing and a developed country, developing countries may have to make significant concessions due to the stringent provisions in the model. Consequently, developing countries like Turkey have raised reservations about various articles in the OECD model (Başok, 2016, p. 55).

In the OECD model treaty, taxation authority, based on the residence principle, is granted to the country where investors or business owners are resident. However, a taxpayer's economic dependence on the country where they have invested capital and earned income cannot be ignored. If taxation is based on the residence principle, the location where income is generated and the potential for profit will be entirely neglected, resulting in unfavorable taxation for developing countries. Thus, it is safe to say that the OECD Model Treaty has not been accepted by developing countries due to the argument that it leads to treasury losses in the source country where income originates.

3.2.2. The UN Model Convention

In cases where developed countries and developing countries are parties of tax treaty, since it would not create a fair ground and would protect the rights of developing countries, the need arose for a new treaty model. This need was addressed by the model developed by the UN, which, unlike the OECD model based on the residence principle, gives priority to the source country. Published in 1980 under the title " UN Model Double Taxation Convention between Developed and Developing Countries," the United Nations Model Convention was last revised in 2021 (UN, New York, 2021).

Although the transfer volume of production factors from developed countries is higher than that from developing countries, due to the larger number of developing countries' involvement, their impact cannot be denied in terms of international double taxation agreements. (Goldberg, 1983, p. 838).

Since the flow of capital among these countries is mainly one-way — from developed to developing countries — being a party of a tax treaty based on the OECD Model may not bring significant benefits to developing countries. The rapidly increasing volume of international trade and the end of the colonialism mindset have led to a need for different principles in agreements between developing and developed countries, thereby increasing interest in the UN Model (Altaş, 2010, p. 63). According to the perspective adopted by the UN Model, treaties should strike a balance between the benefits gained and the sacrifices imposed on the treasury, by taking into account the legal and economic conditions of the contracting states (Çölgezen, 2010, p. 125).

The adoption of the source country principle in the UN Model regarding the sharing of taxing rights has led to the fact that it is being preferred by less developed or developing countries that are primarily importers of capital (Şenyüz *et al.*, 2016, p. 340). The UN model treaty is generally regarded as a better compromise between the costs and benefits for developing countries than the OECD model treaty (Lennard, 2009, p. 4).

In conclusion, the United Nations Model Convention represents a compromise between the source and residence principles, nebertheless, as mentioned above, it places more emphasis on the source principle compared to the OECD Model Convention.

While the UN model is compatible with the OECD model and contains provisions that facilitate the conclusion of double taxation agreements between developed and developing countries, its importance has started to diminish in recent years, with the OECD model gaining more importance and preference (Öncel *et al.*, 2011, p. 74). With that being said, one can argue that the UN Model has achieved its purpose, in a sense, as it has been brought to the forefront in many tax treaty negotiations through provisions not present in the OECD Model, despite having them in itself, since its preparation (McIntyre, 2010, p. 6).

To sum up, as Arnold proposes, the UN Model follows the structure established by the OECD Model, with many of its clauses being either identical or closely resembling them. Thus, it makes sense to consider the United Nations Model Convention as a convention that is introducing important but limited modifications to the OECD Molde, and is not completely distinct from the previous one (Arnold, 2015, p.5).

3.2.3. Methods of Relief Used in Model Conventions

3.2.3.1. Methods Used in The OECD Model

Article 23, under the title "Methods for elimination of double taxation" of the OECD model double taxation treaty, proposes two methods, namely the exemption method in article 23A or the credit method Article 23B, as a choice of relief from double taxation. (Holmes, 2014 p.104)

In the OECD Model, two options are provided for eliminating double taxation: the progressive exemption method and the ordinary credit method. Contracting States are free to choose one of these two methods. Both Contracting States may agree to apply only one of the methods, as separately regulated in the Model, or they may prefer to implement different methods, opting for exemption for some income elements and credit for others.

In this context, Article 23A explains the exemption method. If a resident of one contracting state has income or wealth elements that can be taxed in the other contracting state, the other contracting state can exempt these income and wealth elements from taxation, excluding those falling within the tax jurisdiction of the other country. However, the credit portion of the tax should not exceed the calculated tax amount before crediting. Article 23B deals with the credit method. (OECD, 2019).

In this sense, if a resident of one contracting state has income or wealth elements that can be taxed in the other contracting state, the other contracting state can credit these income and wealth elements from taxation, excluding those falling within the tax jurisdiction of the other contracting state. Therefore, the amount of tax to be levied on the income or wealth of a resident of one contracting state must be equal to the amount credited by the other contracting state.

3.2.3.2. Methods Used in The UN Model

Chapter five of The UN Model Agreement, just like the OECD model, outlines the methods double taxation relief. These methods include the exemption method explained in Article 23A and the credit method detailed in Article 23B. Both the progressive exemption method and the ordinary credit method are recommended in the UN Model, similar to the OECD Model. With Articles 23A and 23B, the UN Model repeats the provisions of the OECD Model regarding both methods.

In theory, the UN Model appears more beneficial for developing countries when compared to the OECD Model. Given their status as importers of capital, developing nations can benefit from the provisions of the UN Model as it relies on source principle, facilitating increased taxation on foreign investments entering their borders (Hearson, 2016, p. 8).

While negotiators from developing countries frequently use the UN Model as a starting point in discussions, the finalized treaties often include, on average, more provisions from the OECD than from the UN. This may stem from the relatively weaker tax laws of developing nations or their limited negotiating capacity (Hearson 2015, p. 32).

Although the systematic structures of the OECD Model and the UN Model are very similar, their fundamental approach to determining which country will exercise taxing authority are different. The UN Model, primarily based on the OECD Model, contains some provisions that differ from the OECD Model in certain aspects. The residence principle is adopted in the OECD Model, emphasizing the taxing authority of the state where the taxpayer is resident. In contrast, the UN Model adopts mostly the source principle, giving weight to the taxing authority of the state where the income arises. The OECD and UN Model Tax Treaties both recommend the progressive exception and ordinary credit method.

3.3. Turkey Model Tax Convention

It is known that countries also make efforts to create treaty models according to their own approaches, apart from the OECD and UN Models. For instance, the U.S. Treasury, initially in 1976, raised concerns about the inadequate regulation of anti-abuse provisions in the OECD Model (Panayi, 2007, p. 27) and the Netherlands published its own model draft in 1988 (Uckmar, 2012, p. 163).

From the perspective of developed country policy, due to the faxt that the tax revenue to be levied on the capital income, labor earnings, and indirect incomes brought by foreign investors may be at a level where it can waive tax revenues, the tax revenue loss will not be significant within its entire economy. Whereas the developing countries need foreign investors. Foreign investors will invest in the country, provide labor, and enable the circulation of foreign currency in the markets. While doing that, they will use the country's resources and pay the taxes on the income they acquire in their country of residence. Any amount of tax not paid on income derived from commercial activities in developing countries will constitute a significant loss for that developing country. (Başak 2005c p. 288).

In developing countries such as Turkey, the shortage of domestic capitals demands a significant reliance on foreign capital investment for these nations to achieve economic development. Considering that foreign capital comes to these countries with the intention of making direct investments in production, these investments also play a crucial role in employment in developing countries. (Başak 2005c p. 288)

The belief that the regulations projected in the OECD and UN Models regarding double taxation will not serve the country's interests, has urged Turkey to develop a model that will produce favorable outcomes (Kızılgül, Beşel, 2019, p. 314). Accordingly, in 1969, Turkish Ministry of Finance published a version of the "Turkish Project for the Prevention of Double Taxation Agreements in Income and Wealth Tax" that is more in line with the economic conditions of the OECD Model but introduces significantly different provisions. Similar to the UN Model, the Turkish Project is based on the principle of transferring the authority of taxing of certain income items – left to the taxing authority of the residence state in the OECD Model – to the source state (Yaltı Soydan, 1995, p. 50).

In other words, in this new Turkey model convention, certain provisions of both the OECD Model Agreement and the UN Model Agreement were combined and modified (Egeli, Özcan, 2014, p. 84). While developing its own model, Turkey, as an OECD country, took the OECD Model as a basis. However, within the framework of reservations and commentaries placed on the OECD Model Convention, Turkey attempted to reflect differences in development levels, priorities, and interests in its model. The primary aim of the Turkish Model is to attract capital to Turkey and facilitate the import of high technology by preventing double taxation (Güngör 1987, p. 34).

Therefore, agreements with developed countries seem to reflect provisions of the United Nations Model. However, the principle of the resident country's ability to exercise the highest taxation for countries to which Turkey exports or can export capital and technology can also be considered. The provisions of the OECD Model Agreement are observed to be reflected in agreements made with developing countries. (Kara, 1995, p. 56)

In the Turkish Model, it is observed that the exemption method is more commonly preferred, compared to the credit method for eliminating double taxation. The main reason for the preference of the exemption method in tax treaties made by Turkey, is stated as the ability of the source state to fully demonstrate the impact of any tax incentive measures it applies to investors after determining which state will tax income the elements – other than interest, dividends, consideration for intangible assets, and gains from the disposal of securities – which are subject to sharing between the two states according to the provisions of the agreement.

The type of exemption method commonly preferred in agreements is the progressive exemption method. This method is defined as exempting the income taxed abroad from the tax in Turkey, for resident individuals in Turkey; conversely, exempting the income taxed in Turkey from the country they are resident, for limited taxpayers earning income in Turkey. This method is implemented combining with the credit method outlined in agreements. When it comes to the credit method, ordinary crediting is applied, and in certain agreements, the existing credit provisions in domestic law are upheld (Soydan, 1994, p. 84).

For example, the scope of the double taxation treaty between Turkey and Germany covers dividends, interest, and royalties as the elements subject to taxes on income. The primary methods considered in this context are exemptions and credits.[3]

On the other hand, in the double taxation treaty between Turkey and Egypt, all income elements are included, and the credit method is the only method applied.[4]

To sum up, in the tax treaties made by Turkey, the overall trend is to follow the OECD model convention. However, agreements with some countries also include provisions related to the UN model convention. This means that Turkey has developed its own unique model, taking its interests into account, that differs from the OECD and UN models. In essence, it can be assumed that Turkey adopts a solution where it can define the terms of double taxation prevention treaties based on the level of development of the counterpart country of that treaty.

3 Treaty for the Prevention of Double Taxation and Tax Evasion on Income between the Republic of Turkey and the Federal Republic of Germany (2011), Official Gazette of the Republic of Turkey, 28183, 24.01.2012.

[4] Treaty for the Prevention of Double Taxation on Income between the Republic of Turkey and the Arab Republic of Egypt (1993), Official Gazette of the Republic of Turkey, 22746, 03.09.1996

CONCLUSIONS

1. The emergence of the problem of international double taxation arises from the complexity that results when the taxation authorities of states are not restricted. To understand the causes of this complexity, it is essential to initially examine the international principles of taxation concerning jurisdiction adopted by states.
2. The economic structures of developing countries find the source principle more suitable, while developed countries' economic structures align better with the residence principle. This is because developed countries typically export more capital and have investors actively engaged in international trade. They aim to maintain taxing rights on income. In contrast, for developing countries where capital imports often exceed exports, prioritizing residence taxation is not advantageous.
3. The credit method is considered the most effective approach to avoid double taxation. However, its intricate structure can present challenges for taxpayers and governments in practice. Therefore, the application of the credit method requires collaboration and information sharing between the tax administrations of different countries. This method has faced criticism for nullifying the impact of tax incentives, such as exemptions and rate reductions applied in the source country.
4. Tax sparing cannot be derived from the traditional objective of double tax treaties. This measure can be unilaterally implemented by states or reciprocally applied.
5. If a country adopts the residence principle and employs the exemption method, it means that it has acknowledged the taxing authority of the source country in taxing foreign income and has waived the worldwide taxation feature of the residence principle. Therefore, income earned in foreign countries is entirely excluded from the calculation.
6. In cases where international double taxation cannot be resolved through bilateral tax agreements, the deduction method is applied as a last resort. In this method, taxes paid abroad are deducted not from the domestic tax obligation but from the total tax base calculated domestically.
7. The most advantageous situation for the taxpayer is the exemption method, while the least efficient method in preventing double taxation is the deduction method.
8. Generally, in Turkey, the credit method is applied for income tax based on the residence principle, while the exemption method is used for taxation based on the nationality principle. For corporate income tax, the credit method is employed.

9. In the residence-based credit method, the ordinary credit method is accepted. In taxation based on nationality, however, the full exemption method is applied.
10. In corporate taxes concerning full liability, there is no difference in the responsibilities and rights of a Turkish company operating under the same conditions as foreign companies before tax laws.
11. Although the systematic structures of the OECD Model and the UN Model are very similar, their fundamental approach to determining which country will exercise taxing authority is different. The OECD Model adopts the residence principle, emphasizing the taxing authority of the state where the taxpayer is resident. In contrast, the UN Model mostly adopts the source principle, giving weight to the taxing authority of the state where the income arises.
12. In developing countries like Turkey, the lack of domestic capital necessitates significant reliance on foreign capital investment for these nations to achieve economic development. In the Turkish model convention, certain provisions of both the OECD Model Agreement and the UN Model Agreement were combined and modified. The primary goal of the Turkish Model is to attract capital to Turkey and facilitate the import of high technology by preventing double taxation.
13. The type of exemption method commonly preferred in agreements is the progressive exemption method, whereas when it comes to the credit method, ordinary crediting is applied

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SUMMARY IN ENGLISH

Methods of International Double Taxation Relief

Utku Karababa

This master's thesis has navigated the complex terrain of international double taxation, sorting out its economic and juridical dimensions and exploring the complicated reasons behind its existence. Through a careful examination of preventive and eliminative regulations, both at the national and international levels, the study compared various relief methods and examined their applications. From the credit and exemption methods to bilateral tax treaties, the research provided a comprehensive overview of the measures countries employ to address the challenges posed by international double taxation.

The study delved into the global effects of double taxation, highlighting the conflicts between different taxation principles and taxpayer categories. After that, by analyzing the application of these measures in Turkey, the research provided valuable insights into the practical implications of unilateral and bilateral approaches.

The final section extended the analysis to international double taxation treaties, examining influential model conventions, namely OECD and UN models. A focused evaluation of relief methods used in these conventions, coupled with an exploration of Turkey's Model Tax Convention, facilitated a different understanding of the strengths and weaknesses inherent in unilateral and bilateral measures.

In summation, this thesis contributes to the scholarly discourse on international double taxation by offering a comprehensive examination of diverse measures employed globally. The insights collected from this research provide a foundation for informed policy discussions and potential enhancements to the international tax landscape. As the global economy continues to evolve, this study serves as a valuable resource for policymakers, tax professionals, and scholars grappling with the challenges of international double taxation.

The emergence of the problem of international double taxation arises from the complexity that results when the taxation authorities of states are not restricted. The economic structures of developing countries find the source principle more suitable, while developed countries' economic structures align better with the residence principle. The credit method is considered the most effective approach to avoid double taxation. However, its intricate structure can present challenges for taxpayers and governments in practice. Therefore, the application of the credit method requires collaboration and information

sharing between the tax administrations of different countries. In developing countries like Turkey, the lack of domestic capital necessitates significant reliance on foreign capital investment for these nations to achieve economic development. In the Turkish model convention, certain provisions of both the OECD Model Agreement and the UN Model Agreement were combined and modified.

SUMMARY IN LITHUANIAN

SANTRAUKA

Atleidimo nuo tarptautinio dvigubo apmokestinimo metodai

Utku Karababa

Šio magistrinio darbo metu buvo nagrinėjamas tarptautinio dvigubo apmokestinimo sudėtingas kontekstas, išskaidant jo ekonomines ir teisines dimensijas bei tyrinėjant sudėtingus priežastis, lemiančias jo egzistavimą. Atidžiai išanalizavus profilaktinius ir eliminacinius reglamentus tiek nacionaliniu, tiek tarptautiniu lygmeniu, tyrinėjime buvo palyginti įvairūs palengvinimo metodai ir ištirtos jų taikymo sritys. Nuo kredito ir išimties metodų iki dvipusio mokesčių susitarimo, tyrimas pateikė išsamų peržiūrą priemonių, kurias šalys naudoja sprendžiant tarptautinio dvigubo apmokestinimo iššūkius.

Tyrimas gilinosi į tarptautinio dvigubo apmokestinimo globalias pasekmes, pabrėždamas konfliktus tarp skirtingų mokesčių principų ir mokesčių mokėtojų kategorijų. Tada, analizuojant šių priemonių taikymą Turkijoje, tyrimas suteikė vertingų įžvalgų į vienašalių ir dvipusių metodų praktinius padarinius.

Paskutinėje dalyje analizė buvo išplėsta į tarptautinius dvigubo apmokestinimo susitarimus, nagrinėjant įtakos turinčius modelių konvencijas, t.y. OECD ir JT modelius. Fokusuota palengvinimo metodų, naudojamų šiose konvencijose, vertinimu kartu su Turkijos modelio mokesčių konvencijos tyrinėjimu, buvo palengvintas skirtingas vienašalių ir dvipusių priemonių stiprybių ir silpnybių supratimas.

Apibendrinant, šis teiginys prisideda prie mokslinės diskusijos apie tarptautinį dvigubą apmokestinimą, siūlydamas išsamų pasaulinių priemonių tyrimą. Iš šio tyrimo surinktos įžvalgos sudaro pagrindą informuotiems politikos diskusijoms ir potencialiems pagerinimams tarptautinėje mokesčių srityje. Kadangi pasaulio ekonomika toliau vystosi,

šis tyrimas tarnauja kaip vertingas išteklius politikos formuotojams, mokesčių specialistams ir mokslininkams, kovojantiems su tarptautinio dvigubo apmokestinimo iššūkiais.

Tarptautinio dvigubo apmokestinimo problemos atsiradimas kyla iš sudėtingumo, kurį sukelia valstybių mokesčių institucijų neapribojimas. Ekonomikos struktūros besivystančiose šalyse laikosi šaltinio principo kaip tinkamesnio, tuo tarpu išsivysčiusių šalių ekonominės struktūros geriau atitinka gyvenamosios vietos principą. Kreditinė metodika laikoma efektyviausiu būdu išvengti dvigubo apmokestinimo. Tačiau jos sudėtinga struktūra gali kelti iššūkių mokėtojams ir vyriausybėms praktikoje. Todėl kreditinio metodo taikymas reikalauja bendradarbiavimo ir informacijos mainų tarp skirtingų šalių mokesčių administracijų. Besivystančiose šalyse, kaip ir Turkijoje, vidinio kapitalo stokos dėl šių šalių ekonominio vystymosi reikalauja didelio priklausymo nuo užsienio kapitalo investicijų. Turkijos modelio susitarime buvo sujungtos ir modifikuotos tam tikros abiems OECD modelio sutarties ir Jungtinių Tautų modelio sutarties nuostatos.