

Amended: Exceptions to F/X Restrictions in Contracts Between Turkish Residents

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The Ministry of Treasury and Finance amended the recently introduced exceptions to the restriction on F/X denominated or indexed contracts between Turkish residents.

The Ministry of Treasury and Finance (the “**Ministry**”) had announced the first set of exceptions to the general prohibition back in early October. Ever since, consensus has been met in the public opinion that further revisions were needed for the exceptions to actually meet the needs of the real sector. The new set of exceptions announced on November 16 seem to address a number of ambiguities and provide clarity on matters which were constituted grey areas under the previous legislation. However, there remains a significant variety of business dealings to be affected by the F/X pricing restriction and the mandatory requirement to be denominated in Turkish Lira - impacting both prospective and existing contracts.

Background

Decree No. 32, the primary Turkish regulation governing foreign exchange transactions in Turkey, was earlier amended by [Decree No. 85](#) to introduce restrictions on F/X denomination or indexing of payment obligations under contracts to be executed between persons residing in Turkey for (i) sale, (ii) lease (including financial leasing), (iii) employment, (iv) services, and (v) construction, subject to the exceptions to be determined by the Ministry. The restriction required existing contracts with F/X pricing to be re-priced in Turkish Lira by October 13, 2018.¹

The Ministry addressed many of these requests of the market in the first list of exceptions² announced on October 6, 2018, but left out some of the exceptions that were earlier hinted at in public statements, such as the exceptions for Turkish residents who have outstanding F/X denominated financing costs and are eligible to borrow in F/X. Following the continuance of requests for revisions and additions to the exceptions, the Ministry introduced a new communiqué³ on November 16, 2018 and amended the exceptions.

What's New?

I. Excepted Matters

- The previous version of the Communiqué provided the least amount of exceptions in relation to contracts for the sale or lease of real property. In this amended version, contracts for:
 - the sale / lease of properties in free zones;

¹ Please follow this link for our [Client Update](#) on Decree No 85.

² Please follow this link for our [Client Alert](#) on the initial list of exceptions.

³ Communiqué (No. 2018-32/52) published in the Official Gazette dated November 16, 2018 and numbered 30597.

- sale / lease executed by the following persons, as a buyer / lessee;
 - non-Turkish citizens;
 - branches, representative offices, offices, liaison offices of non-Turkish residents;
 - companies, 50% or more of whose share capital is held by or which are jointly/individually controlled by non-Turkish residents; and
 - companies operating in free trade zones, within the scope of their activities in the zone
- the lease of accommodation facilities certified by the Ministry of Culture and Tourism; and
- the lease of duty-free stores,
- are excepted from the restriction.
- Sale and lease of movable property already benefitted from a general exception, which only left out sale / lease contracts relating to vehicles, including construction equipment. With these recent amendments, construction equipment are not declassified from the sale / lease of vehicles and can be sold / leased with F/X pricing.
- Exceptions for construction contracts are also significantly expanded. Construction contracts between Turkish residents that carry F/X-based costs can now be denominated in or indexed to F/X.
- All service contracts (i) originating and ending abroad, or (ii) originating in Turkey and ending abroad or vice versa, can be priced in F/X.
- Before the amendments, contracts, other than the sale and lease of real property, executed by contractors (*yüklenici*) and third parties, within the scope of the performance of tenders, contracts and treaties with F/X pricing and executed by public entities and institutions, were excepted.
 - The amendments allow F/X pricing in all contracts, other than sale of real property, to be executed in relation to projects implemented under tenders, contracts and treaties with F/X pricing and executed by public entities and institutions. Commissioned companies (*görevli şirket*) (besides contractors (*yüklenici*)) and the parties executed contracts with commissioned companies and contractors (i.e., sub-contractors) are possible parties, whose contracts are excepted under the aforementioned exception.
- All contracts executed in relation to the Law No. 4749 on Regulating Public Financing and Debt Management are excepted from the restriction. This exception previously applied only to banks' contracts within the scope of the referred legislation.
- Previously, all employment and service contracts, to which the branches, representatives, offices, liaison offices of; or companies held by more than 50% shareholding by non-Turkish residents were granted an exception.
 - Companies individually or jointly controlled by non-Turkish residents are included in the exception, in addition to companies held by 50% or more shareholding by non-Turkish residents.
 - The amendments restrict the scope of such exception and only allow F/X pricing in such employment / service contracts, to which the abovementioned foreign-affiliated persons are party as an **employer or service receiver**.

Please follow this [link](#) for a fully updated chart showing the exceptions to the F/X pricing restriction.

II. Implementation of the Restriction

- **Re-pricing Obligation:** All existing contracts affected by the restriction, as well as negotiable instruments, to the extent that their underlying contracts are affected, must be re-priced in Turkish Lira. The only exception to the re-pricing obligation was applicable to vehicle lease contracts executed before September 13, 2018. Pursuant to the amendments, (i) commercial passenger carriage contracts and financial leasing contracts for movable or immovable property executed before September 13, 2018, (ii)

deposits made under real property leases before September 13, 2018, and (iii) negotiable instruments, which have been issued and circulated before September 13, 2018 are not required to be re-priced.

- **F/X Pricing:** Indexing to precious metals and commodity, the price of which is denominated in F/X in international markets, are also considered F/X pricing for the purposes of this restriction. However, the amendments grant an exception to carriage contracts for indexing to oil prices.
- **Turkish Residency.** Branches, representatives, offices, liaison offices, managed or operated funds and companies held by 50% or more shareholding by Turkish residents are also considered Turkish residents. The amendments provide that this will not apply for contracts to be performed abroad.

III. Stamp Tax Duties in Repriced Contracts

- On November 22, 2018, following the amendment of the exceptions, the Revenue Administration issued a circular on stamp tax obligations that will arise due to the repricing of contracts pursuant to the F/X pricing restriction (the “**Circular**”).
- The Circular clarifies that, pursuant to the existing tax legislation, repriced contracts will not trigger stamp tax obligations if;
 - (i) the repriced TL-denominated amount; is lower than (ii) the TL equivalent of the outstanding amount of the previous F/X-denominated price, converted based on the Turkish Central Bank’s selling rate on the repricing date;
 - a reference to the original contract is made; and
 - there are no other amendments to the contract other than the repricing (e.g., new parties, term extension, new services).
- If any of the conditions above are not met, the repricing will trigger stamp tax obligations.

Commentary

- Supported by the public statements of the authorities, the market anticipated that the Ministry would follow the exceptions to [F/X borrowing rules](#). The amended exceptions remain disconnected to the rules allowing Turkish companies to undertake F/X-denominated financial obligations which were introduced earlier this year. This may ultimately lead to discrepancies between the financial obligations of companies and the commercial transactions from which they derive their income to meet their financial obligations.
- The exception for employment and service contracts executed by certain foreign-affiliated parties addressed significant concerns of foreign investors in Turkey, while failing to cover all transactions entered into by foreign investors. The narrowed-down scope of the exception will cause further business relationships (especially for foreign advisors) to be affected by the restriction.
- The revisions in the exception relating to projects with public entities / institutions seem as an attempt to cover all PPP and BOT-type projects. However, Ministry’s further announcements on a list of “public institutions and entities” are awaited, to see if certain state-owned entities, which are involved in numerous PPP/BOT projects will be covered by the exception.
- While construction contracts with F/X-costs are entitled to greater freedom in terms of F/X pricing, clarifications on the cost items, the F/X-denomination of which will constitute “F/X costs” for the purposes of this exception, are needed. Currently, it is not certain whether such cost items refer only to costs built-into the construction work (e.g., equipment, material) or also others such as the costs for the financing of the construction project.
- The amendments do not regulate a transition period for contracts excepted by the amendments, which did not benefit from the initial exceptions and had already been repriced. The re-pricing period allowed for contracts removed from the scope of the exceptions with these amendments, is also uncertain.

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