

# GEDİK & ERAKSOY

19 November 2018

## *A Brief Overview of the Recent Amendments to the Turkish Foreign Exchange Legislation*

### ➤ **Speed Read**<sup>1</sup>

*Following the amendments made to the Decree No.32 on Protection of the Value of the Turkish Currency (Decree No. 32) on 13 September 2018 (Amendments), which envisage a prohibition on the use of, or indexing to, foreign currency in certain types of contracts entered into by and between Turkish and non-Turkish real and legal persons resident in Turkey, the Ministry of Treasury and Finance (Ministry) had introduced, on 6 October 2018, an amendment to the Communiqué No. 2008-32/34 regarding the Decree No.32 (Communiqué) with a view to flesh out the scope of the restrictions introduced by the Amendments and exemptions thereof.*

*On 16 November 2018,, the Communiqué has been further amended by a new set of changes published in the Official Gazette, which prompted us to walk through the current status of exemptions and restrictions with regards to each type of contract captured by the Amendments in a comprehensive approach.*

### ➤ **Highlights**

#### **(a) General Overview**

The Amendments had recently provided that, save for the exemptions to be determined by the Ministry, the contract price and all other payment obligations under the purchase and sale, and lease agreements with regards to movables and immovable property; as well as financial lease, vehicle, employment, service, and works agreements entered into between Turkish and non-Turkish real and legal persons resident in Turkey must be based on Turkish Lira. In other words, the Amendments had precluded Turkish residents from determining, or indexing to, the contract price or other payment obligations in foreign currency with regards to the aforementioned transactions.

Further, a 30-day transition period had been envisaged by the Amendments for the Turkish and non-Turkish real and legal persons resident in Turkey to amend their existing agreements which fall within the scope of the restrictions such that the contract price and all other payment obligations thereunder must be re-determined in Turkish Lira.

In this regard, the exact scope of restrictions and exemptions introduced by the Amendments has been laid down by the Ministry under the Communiqué. Accordingly, we intended hereinbelow to

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<sup>1</sup> Please see Schedule 1 for the summary chart.

dwell on the restrictions and exemptions applicable to each contract type captured by the Amendments.

**(b) Restrictions**

Unless an exemption applies, the following contract types entered into by and between Turkish and non-Turkish real and legal persons resident in Turkey are captured by the restrictions, and, therefore, contract price and other payment obligations thereunder must not be determined, or indexed to, foreign currency.

**(i) Purchase and Sale Agreements in relation to Immovable Property**

According to the Communiqué, Turkish and non-Turkish real and legal persons resident in Turkey are not allowed to determine, or index to, the contract price in foreign currency when entering into purchase and sale agreements between one another in relation to immovable properties, including, but not limited to, residences and business places covered with a roof. In accordance with the latest amendment to the Communiqué this restriction no longer applies to immovable properties located in free zones.

That being said, purchase and sale agreements entered into by the following persons in their capacity as purchaser are exempt from the restrictions and, therefore, contract price and other payment obligations thereunder may be determined, or indexed to, foreign currency:

- (A) a foreign individual resident in Turkey; or
- (B) Turkish branch, representation office, office, liaison office or subsidiary of a foreign entity or a foreign person holding, directly or indirectly, shares representing, at least, 50% of the share capital or having sole or joint control thereof.

**(ii) Lease Agreements in relation to Immovable Property**

As is the case with purchase and sale agreements for immovable property, Turkish and non-Turkish real and legal persons resident in Turkey are not allowed to determine, or index to, the contract price in foreign currency when entering into lease agreements between one another in relation to immovable properties, including, but not limited to, residences and business places covered with a roof.

The foregoing restriction, however, does not apply to lease agreements:

- (A) entered into for operation of accommodation facilities certified by the Ministry of Culture and Tourism;
- (B) entered into relating to a duty-free shop; or
- (C) entered into by the following persons in their capacity as lessee:
  - I. a non-Turkish real person resident in Turkey;
  - II. Turkish branch, representation office, office, liaison office or subsidiary of a foreign entity or a foreign person holding, directly or

indirectly, shares representing, at least, 50% of the share capital or having sole or joint control thereof; or..

- III. in connection with its activities in the free zone, a company located in a free zone.

**(iii) Employment Agreements**

Employment agreements entered/to be entered into between residents in Turkey must not include a contract price and other payment obligations denominated in, or indexed to, foreign currency; except that employment agreements:

- (A) to be performed outside of Turkey;
- (B) entered into by seamen;
- (C) entered into by foreign individuals residing in Turkey;
- (D) entered into by the Turkish branch, representation office, liaison office or subsidiary of a foreign entity or a foreign person holding, directly or indirectly, shares representing, at least, 50% of the share capital or having sole or joint control thereof, acting as the employer; and
- (E) entered into by companies located in free zones, in their capacity as employer, in connection with their activities therein,

are exempt from the restrictions and, accordingly, contract price and other payment obligations under such employment agreements may be denominated in, or indexed to, foreign currency.

**(iv) Service Agreements (including Consultancy, Brokerage and Transportation Agreements)**

Save for the following exemptions, Turkish and non-Turkish real and legal persons resident in Turkey are not allowed to determine, or index to, the contract price in foreign currency when entering into service agreements, including consultancy, brokerage and transportation agreements (collectively, **Service Agreements**), between each other:

- (A) Service Agreements entered into by foreign individuals residing in Turkey;
- (B) Service Agreements entered into within the framework of export, transit trade, sale and deliveries considered as export (*ihracat sayılan satış ve teslimler*) and foreign currency generating services and activities;
- (C) Service Agreements entered into by the Turkish branch, representation office, liaison office or subsidiary of a foreign entity or a foreign person holding, directly or indirectly, shares representing, at least, 50% of the share capital or having sole or joint control thereof, acting as the service recipient;
- (D) entered into by companies located in free zones, in their capacity as service recipient, in connection with their activities therein;

- (E) Service Agreements which are in relation to services/activities to be performed outside of Turkey; and
- (F) Service Agreements entered into in relation to the services starting in Turkey and ending abroad or the other way around or otherwise regarding the services starting and ending abroad.

**(v) Works Agreements**

Save for those where the costs relating to the relevant works are denominated in foreign currency, works agreements entered into between Turkish and non-Turkish real and legal persons resident in Turkey must not include a contract price and other payment obligations denominated in, or indexed to, foreign currency.

**(vi) Purchase and Sale Agreements/Lease Agreements in relation to Vehicles**

According to the Communiqué, Turkish and non-Turkish real and legal persons resident in Turkey are not allowed to determine, or index to, the contract price in foreign currency when entering into purchase and sale agreements or lease agreements between one another in relation to vehicles. In accordance with the latest amendment to the Communiqué this restriction no longer applies to heavy machinery.

Note that movables other than vehicles are exempt from the restrictions and, therefore, contract price and other payment obligations thereunder can be determined, or indexed to, foreign currency.

**(vii) Sale Agreements regarding Software/License and Service Agreements regarding Software and Hardware**

According to the Communiqué, contract price and other payment obligations under sale agreements regarding software, as well as license and service agreements regarding software and hardware may be determined, or indexed to, foreign currency, provided that the relevant software and/or hardware, as the case may be, has been produced outside of Turkey.

Therefore, by virtue of *argumentum a contrario*, where the software and/or hardware is produced in Turkey, parties to sale agreements (in the case of software only) and license and service agreements (in the case of software and hardware) must not determine or index the contract price to foreign currency.

**(viii) Financial Leasing Agreements**

Turkish and non-Turkish real and legal persons resident in Turkey may determine, or index to, contract price and other payment obligations in foreign currency where they enter into financial leasing agreements in respect of ships<sup>2</sup>.

Further, financial leasing agreements to be entered into within the framework of Article 17 and 17/A of the Decree No. 32 may include contract price and other payment obligations denominated in, or indexed to, foreign currency. Accordingly, if a leasing agreement entered into by and between Turkish and non-Turkish real and legal persons resident in Turkey is in relation to foreign currency denominated

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<sup>2</sup> Only the ships that are defined under the Law No. 4490 on Turkish International Ship Registry and the Law Amending the Decree No. 491.

borrowings (obtained from or outside of Turkey), then the contract price and other payment obligations in the leasing agreement may be denominated in, or indexed to, foreign currency.

Since there are no other exemptions set out under the Communiqué, we take the view that financial leasing agreements other than the foregoing are captured by the restrictions and must be concluded in Turkish Lira.

**(c) Exemptions**

According to the Communiqué, the following contract types will be exempt from the obligation to determine the contract price in Turkish Lira, unless otherwise provided therein.

**(i) Capital Market Instruments**

The Communiqué includes an explicit exemption for capital market instruments. Accordingly, issuance, purchase and sale of capital market instruments in accordance with the Capital Markets Law No. 6362 and its secondary legislation; as well as determination of obligations in connection therewith, may be denominated in, or indexed to, foreign currency.

Please kindly note that the foregoing exemption extends to foreign capital market instruments, depositary receipts and foreign investment funds, as well.

**(ii) Agreements of Public Entities**

Save for paragraph (iii) below and except for the purchase and sale of, and lease agreements, in relation to immovable property, agreements entered into by public entities and the companies owned by Turkish Armed Forces Foundation are exempt from the restrictions introduced by the Amendments and the Communiqué.

**(iii) Agreements entered into by Contractors of Public Procurements, Agreements and International Treaties**

Agreements (other than purchase and sale in relation immovable property and employment agreements) entered into by contractors, responsible companies under the aforementioned agreements and parties with whom such contractors and responsible companies enter into relevant agreements, within the framework of projects to be implemented under the agreements, tenders or international treaties (denominated in, or indexed to, foreign currency) concluded by public entities for the execution thereof, are allowed to enter into foreign currency denominated or indexed agreements with third parties within the framework of the aforementioned projects.

**(iv) Agreements entered into within the framework of the Public Finance Law<sup>3</sup>**

According to the Communiqué, agreements entered into within the framework of transactions performed under the Public Finance Law are exempt from the restrictions, and, accordingly, contract price and other payment obligations thereunder may be determined in, or indexed to, foreign currency. Further, agreements entered into by banks in connection with the transactions to be carried out within the framework of the Public Finance Law also benefit from the exemption.

**(v) Certain Agreements regarding Civil Aviation Services**

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<sup>3</sup> The Law No. 4749 on Regulation of Public Finance and Debt Management

Save for the purchase and sale and lease agreements in relation immovable property and employment agreements, agreements entered into by (i) commercial airline operators engaging in passenger, freight and postal transportation services; (ii) entities providing maintenance and repair services to air vehicles, their engines and mechanical parts; and, (iii) entities authorised to provide ground services in accordance with the applicable civil aviation legislation; as well as their subsidiaries where they directly or indirectly hold shares representing, at least, 50% of the share capital, are allowed to enter into foreign currency denominated or indexed agreements.

**(d) Other Notable Issues**

**(i) Settlement of Disputes**

Prior to the amendments to the Communiqué, the applicable legislation was silent as to the route to be followed in case of disputes between the parties in re-determining the contract price and other payment obligations in Turkish Lira.

In this respect, the Ministry has addressed this issue by way of introducing a mechanism for determination of the contract price under the agreements which fall within the scope of restrictions and whose parties are not able to agree. Accordingly, the currency exchange rates of the Central Bank of Turkey as at 2 January 2018 are to be applied for conversion into Turkish Lira, if the parties fail to come to an agreement on the contract price and/or other payment obligations. Afterwards, the resulting Turkish Lira equivalent will be increased in line with the consumer price index, announced by Turkish Statistical Institution on a monthly basis, to reach the contract price at the time of the determination.

**(ii) Prior Payments and Defaulted Payments**

According to the Communiqué, where an existing agreement denominated in, or indexed to, foreign currency is required to be amended until 13 October 2018 to comply with the recent restrictions, (i) the payments obligations already performed in foreign currency; (ii) defaulted payments; (iii) deposits previously provided within the context of immovable property leases; and, (iv) negotiable instruments previously issued for the performance of obligations under the agreements, would not need to be converted into Turkish Lira.

**(iii) Negotiable Instruments**

The Communiqué provides that if the underlying agreement is captured by the restrictions (and therefore cannot be denominated in, or indexed to, foreign currency), negotiable instruments issued in reliance upon these agreements cannot be denominated in, or indexed to, foreign currency. Please kindly note that negotiable instruments drawn and issued prior to 13 September 2018 benefit from exemptions in any case (*i.e.*, regardless of the underlying agreement's status vis-à-vis the restrictions).

**(iv) Indexation to Precious Metals and Commodities**

Agreements where the contract price or other payment obligations are indexed to precious metals or commodities whose price is determined in foreign currency in the international markets are also captured by the restrictions introduced by the Amendments. However, service agreements in connection with transportation activities may be indexed to oil prices.

**(v) Status of Turkish Companies' Foreign Branches, Subsidiaries and Offices**

According to the Communiqué, a Turkish legal entity's branches, representation offices, offices, liaison offices and subsidiaries – where such Turkish company holds, directly or indirectly, shares representing, at least, 50% of the share capital – located outside of Turkey are each considered to be a “legal person resident in Turkey” for the purposes of the implementation of the restrictions under the Communiqué. That being said, if an agreement entered into by such entities is performed outside Turkey, then such agreement is exempt from the restrictions.

**(vi) Re-Determination in Lease Agreements for Residences and Business Places covered with a Roof**

The contract price and other payment obligations under the lease agreements for residences and business places covered with a roof that were entered into prior to the date of the Amendments (*i.e.*, 13 September 2018) will be re-determined for a period of two years. If parties fail to agree on the contract price, the conversion rate of the Central Bank of Turkey as at 2 January 2018 would be applied to reach the base amount. Following this, the base amount will be increased to reflect the consumer price index until the determination date.

**(e) Sanctions**

Any non-compliance by Turkish and non-Turkish real and legal persons resident in Turkey with the foregoing requirements would be subject to an administrative fine between TRY6,306 (circa USD1,190) and TRY52,601 (circa USD9,900) for the year 2018.

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## SCHEDULE 1

### SUMMARY CHART FOR THE SCOPE OF THE AMENDMENTS

Colour Code	
<b>White</b>	Captured by the restrictions with no exemptions
<b>Orange:</b>	Captured by the restrictions with certain exemptions
<b>Green</b>	Exempt from restrictions

Contract Type	Restriction	Exemption	Notes
<b>Purchase and Sale Agreements for Immovable Property</b>	✓	✓	Exempt if entered into by the following in their capacity as purchaser: <ul style="list-style-type: none"> <li>• a foreign individual resident in Turkey;</li> <li>• Turkish branch, representation office, office, liaison office or subsidiary of a foreign entity or a foreign person holding, directly or indirectly, shares representing, at least, 50% of the share capital or having sole or joint control thereof; or</li> <li>• a company located in a free zone, in connection with its activities in the free zone.</li> </ul>
<b>Lease Agreements for Immovable Property</b>	✓	✓	Exempt if: <ul style="list-style-type: none"> <li>• entered into for operation of accommodation facilities certified by the Ministry of Culture and Tourism;</li> <li>• entered into in relation to a duty-free shop</li> <li>• entered into by a foreign individual resident in Turkey, as lessee;</li> <li>• entered into by the Turkish branch, representation office, office, liaison office or subsidiary of a foreign entity or a foreign person holding, directly or indirectly, shares representing, at least, 50% of the share capital or having sole or joint control thereof, as lessee; or</li> <li>• entered into by a company located in a free zone, as lessee.</li> </ul>
<b>Employment Agreements</b>	✓	✓	Exempt if: <ul style="list-style-type: none"> <li>• performed outside of Turkey;</li> <li>• entered into by seamen;</li> <li>• entered into by foreign individuals residing in Turkey;</li> <li>• entered into the Turkish branch, representation office, liaison office or subsidiary of a foreign entity or a foreign person holding, directly or indirectly, shares representing, at</li> </ul>

			<p>least, 50% of the share capital or having sole or joint control thereof, acting as the employer; and</p> <ul style="list-style-type: none"> <li>entered into by companies located in free zones, in their capacity as employer, in connection with their activities therein.</li> </ul>
<b>Service Agreements</b>	✓	✓	<p>Exempt if:</p> <ul style="list-style-type: none"> <li>entered into by foreign individuals residing in Turkey;</li> <li>entered into within the framework of export, transit trade, sale and deliveries considered as export and foreign currency generating services and activities;</li> <li>entered into for the services/activities to be performed outside of Turkey; and</li> <li>entered into by the Turkish branch, representation office, liaison office or subsidiary of a foreign entity or a foreign person holding, directly or indirectly, shares representing, at least, 50% of the share capital or having sole or joint control thereof, acting as the service recipient;</li> <li>entered into by a company located in free zones is party, as service recipient, in connection with their activities therein;</li> <li>entered into in relation to the services starting in Turkey and ending abroad or the other way around or otherwise regarding services starting and ending abroad.</li> </ul>
<b>Works Agreements</b>	✓	✓	Exempt where the costs related to the relevant works are denominated in foreign currency
<b>Purchase and Sale Agreements for Vehicles other than heavy machinery</b>	✓		
<b>Lease Agreements for Vehicles other than heavy machinery</b>	✓		
<b>Purchase and Sale Agreements for Movables other than Vehicles</b>		✓	
<b>Lease Agreements for Movables other than Vehicles</b>		✓	
<b>Sale Agreements for Software Produced in Turkey</b>	✓		
<b>Sale Agreements for Software Produced outside of Turkey</b>		✓	
<b>License and Service Agreements regarding Software and Hardware Produced in Turkey</b>	✓		
<b>License and Service Agreements regarding Software and Hardware Produced outside of Turkey</b>		✓	

<b>Financial Leasing Agreements</b>	✓	✓	Exempt if: <ul style="list-style-type: none"> <li>• in relation to ships;</li> <li>• linked to fx / fx indexed loans.</li> </ul>
<b>Agreements for Capital Market Instruments</b>		✓	
<b>Agreements of Public Entities</b>	✓	✓	Not exempt if: <ul style="list-style-type: none"> <li>• in relation to purchase and sale agreements for real estate; and</li> <li>• in relation to lease agreements for real estate.</li> </ul>
<b>Agreements of Contractors of Public Procurements, Agreements and International Treaties</b>	✓	✓	Not exempt if: <ul style="list-style-type: none"> <li>• in relation to purchase and sale agreements for real estate;</li> <li>• in relation to employment agreements.</li> </ul>
<b>Agreements entered into (by Banks) within the framework of the Public Finance Law</b>		✓	
<b>Agreements regarding Civil Aviation Services</b>	✓	✓	Not exempt if: <ul style="list-style-type: none"> <li>• in relation to purchase and sale agreements for real estate;</li> <li>• in relation to lease agreements for real estate;</li> <li>• in relation to employment agreements.</li> </ul>