YEGIN CIFTCI
ATTORNEY PARTNERSHIP

TURKEY CLARIFIES THE SCOPE OF FX RESTRICTIONS

On 13 September 2018, Executive Order No. 85 (the "**Executive Order**") was published amending the Decree No. 32 on the Protection of the Value of the Turkish Currency (the "**Decree**").

With the Executive Order, Turkey has restricted the ability to select foreign currency in certain contracts between Turkish residents (as described under the Decree). The authorities have adopted a comprehensive approach by giving these restrictions a retroactive effect and setting a 30-day deadline from the date of publication of the Executive Order (the "**FX Restrictions**") for amending existing contracts. The Executive Order also indicated exemptions would be issued by the Ministry of Treasury and Finance (the "**Ministry**") in respect of the restrictions.

Just one week short of the deadline, the Ministry has restructured the FX Restrictions and announced the long-awaited exemptions with the Communiqué on the Amendment to the Communiqué (numbered 2008-32/34) on the Decree (the "**Communiqué**") which also includes repricing rules for contracts falling out of the scope of exemptions.

I. SCOPE OF APPLICATION

1. Who are the Turkish Residents?

The Decree broadly defines the term "Turkish resident" as any person (be it a legal entity or an individual) including a Turkish national living abroad as an employee or freelancer who have legal residence in Turkey. Further the Communiqué provides that:

i. branches, representative offices or liaison offices of or funds operated by;

ii. companies at least fifty per cent. of whose share capital belongs to; and

iii. companies directly or indirectly owned by,

Turkish residents located abroad will be deemed as Turkish residents for the purposes of the FX Restrictions.

2. FX Restrictions and Exemptions

1. Public Entities

Contracts with Public Entities

The payables under the contracts executed by public entities or by the Turkish Armed Forces Foundation companies (e.g. TAI and ASELSAN) (e.g. project/implementation contracts) can be denominated in or indexed to foreign currency provided that such contracts do not relate to the sale or lease of real estate.

PPP Projects

The Communiqué has provided an explicit exemption to FX Restrictions for contracts executed between contractors and third parties (excluding real estate sale or lease and employment contracts) provided that such contracts are executed to perform obligations arising in relation to (i) tenders, (ii) contracts and (iii) international contracts in each case denominated in or indexed to foreign currency entered into by public entities.

Accordingly, the Communiqué clarified that contracts such as EPC O&M contracts and other services arrangements executed pursuant to BOT or other forms of PPP projects are exempt from the FX Restrictions. On the other hand, the exemptions under the Communiqué do not provide full coverage to PPP projects and certain ancillary contracts may still require conversion.

Sovereign Liabilities

The administration reassured the banking sector in relation to sovereign liabilities including contingent liabilities undertaken for government-backed financing deals. Pursuant to the Communiqué, the contract price or other payment obligations under contracts entered into by banks in relation to the transactions carried out by the Ministry under the Public Finance and Debt Management Law (Law No. 4749) are allowed to be denominated in or indexed to a foreign currency.

2. Services and Employment

Foreign Investors

The Communiqué provides that:

i. foreign companies' branches, representative offices or liaison offices located in Turkey; and

ii. companies with at least 50% direct or indirect foreign share capital,

may execute employment or service contracts denominated in or indexed to foreign currency. Companies established within free trade zones may also enjoy this exemption for the employment and service contracts executed for their operations within the relevant free trade zone.

Employment Contracts

The Communiqué has clarified the position of expatriates and Turkish residents working abroad.

Employment contracts of Turkish nationals who are performing their work in Turkey cannot be denominated in or indexed to foreign currency.

However, regardless of the nationality of their employer, salaries and ancillary payments of (i) expatriates (i.e. individuals who are not Turkish nationals) employed in Turkey or (ii) Turkish nationals working abroad can be denominated in or indexed to foreign currency.

Service Contracts

The Ministry has followed a similar approach to employment contracts in setting the framework of the FX Restrictions for service contracts, by allowing services which will be provided (i) abroad by Turkish residents or (ii) by foreign nationals in Turkey to be exempt from the FX Restrictions.

Transit Trade and Export

Given its geographical position, Turkey is a key country in the region for transit trade, which strengthens its position amongst its competitors as an exporter. Bearing this in mind, the Ministry has excluded from the scope of the FX Restrictions service contracts executed for:

i. export, transit trade, sale and deliveries deemed to be export; and

ii. services that generate foreign currency.

E-communication

Under the Communiqué, service contracts in relation to cross-border e-communication are also exempt from the FX Restrictions.

3. Sale & Lease Contracts

Real Estate

In the past two decades, particularly in commercial real estate, the Turkish market has closely embraced the sale and lease of real estate in foreign currency. However, recent fluctuations in FX and inflation rates have adversely impacted the market practice. To minimise these impacts, the Communiqué provides that Turkish residents may no longer determine the payables arising from real estate sale and lease transactions, including those located in free trade zones, to be denominated in or indexed to foreign currency.

Movable Assets

Contrary to the approach adopted for real estate, the purchase price/rent in respect of movable assets may be denominated in or indexed to foreign currency, provided that the movable asset is not a vehicle (including heavy machinery). This exemption primarily aims at keeping rising consumer price index ("**CPI**") rates at bay and protecting consumer rights, as a great portion of vehicles and machinery are heavily dependent on foreign currency. Please note that the existing contracts regarding the lease of vehicles are exempt from FX Restrictions.

Financial Leasing

The Communiqué provides that financial leasing contracts (i) in relation to sea vessels as defined under the relevant legislation[1] and (ii) executed within the scope of Articles 17 and 17/A of the Decree will be exempt from the FX Restrictions. Please find detailed information regarding Articles 17 and 17/A of the Decree, which regulates the extension of onshore and offshore loans, here.

4. Other

Precious Metals

Under the Communiqué, contracts, indexed to precious metals and/or commodities whose values are based on foreign currency in international markets and/or indirectly indexed to foreign currency are considered as "contracts indexed to foreign currency" and are subject to the FX Restrictions under the Communiqué.

Air Transportation

The Communiqué provides that payables under contracts entered into by Turkish residents that are (i) commercial airline enterprises that carry goods, mail or passengers, (ii) technical maintenance providers for aircrafts, (iii) private or public entities offering ground services at the airports under civil aviation legislation, and (iv) enterprises and companies established, or at least fifty per cent. of whose shares are directly or indirectly owned by the foregoing entities can be denominated in or indexed to foreign currency.

Information Technology

The Ministry allows Turkish residents to execute contracts denominated in or indexed to foreign currency regarding (i) the sale of software developed abroad and (ii) the licensing and service contracts regarding hardware and software.

Negotiable Instruments

The Communiqué indicates that only negotiable instruments that are prepared in relation to contracts exempt from FX Restrictions may be denominated in or indexed to foreign currency. This particular restriction seems to suggest that no other negotiable instruments can be denominated in or indexed to foreign currency which gives rise to a question as to whether any such negotiable instrument can be issued in respect of eligible FX loans.

---

[1] Turkish International Ship Registry Law dated 16 December 1999 and numbered 4490 and the Law regarding the Amendment on the Statutory Decree No. 491.

Manufacturing, Construction or Other Similar Contracts

The Communiqué provides that the payables under manufacturing, construction and other similar contracts (*eser sözleşmeleri*) may not be denominated in or indexed to foreign currency except for construction, repair and maintenance contracts of sea vessels. This exemption is of particular importance as EPC contracts that have not been executed within the scope of (i) a PPP and/or BOT or similar structures or (ii) in respect of building a vessel, would fall under this category, requiring these contracts to be executed in or converted to Turkish Lira.

II. REPRICING RULES

The Communiqué requires that the existing contracts falling within the scope of the FX Restrictions must be mutually revised to provide for payment in Turkish Lira by 13 October 2018. If the parties fail to reach an agreement by this deadline, the repricing rules under the Communiqué would apply.

The repricing rules are only applicable to receivables and claims that are not collected or not overdue.

The Ministry sets the reference conversion date in the Communiqué as 2 January 2018[2], where Turkish lira rate was comparatively strong. If the parties fail to reach an agreement by the deadline, payables denominated in or indexed to a foreign currency will be redetermined by converting the payables at the applicable selling rates (*efektif satış kuru*) of the Central Bank on 2 January 2018 and, increasing such amounts considering the monthly CPI change rates determined by the Turkish Statistical Institute between 2 January 2018 and the repricing date.

The Communiqué specifically regulates the repricing mechanism for real estate lease contracts executed before 13 September 2018. The payment obligations under the real estate lease contracts for residences and workplaces that are denominated in or indexed to a foreign currency must be converted into Turkish Lira for the following two years in accordance with the foregoing general repricing rule. Following the end of the first year after the conversion, if the parties cannot mutually agree on an annual increase denominated in Turkish Lira, the Turkish Lira amount will be increased considering the monthly CPI change rates as determined by the Turkish Statistical Institute between the date of conversion and the end of the relevant lease year.

III. CONCLUSION

For the past couple of years, Turkish Lira has been losing value against foreign currency. A number of Turkish companies have been affected by the plunge in local currency and are facing difficulties with their payments. Regulatory authorities are putting in place certain controls to provide some level of comfort to certain sectors, including construction and real estate that have seen significant growth in Turkey for the past two decades.

As a general observation, we would note that the Communiqué attempts to enable certain contracts to enjoy the exemption to the extent these contracts feature specific foreign element (e.g. nationality, FX generation, export related activities, air and maritime transport etc.) or are related to projects of certain kind (e.g. BOT, PPP etc.). Real estate sale, lease and non-PPP related contracts are particularly targeted to tackle the dominancy of foreign currency whilst a more lenient approach is taken with regard to movable sale and lease (except for vehicles etc.)

There still remains however, some areas which can benefit from further clarifications as set above. It would therefore be reasonable to closely monitor the implementation of these rules in order to determine their impact.

[2] The banknote selling rates of the Central Bank of the Republic of Turkey on 2 January 2018 for selected foreign currencies are: (i) USD/TRY: 3,7776, (ii) EUR/TRY: 4,5525 and (iii) GBP/TRY: 5,1252.

CONTACTS

Mete Yegin
Partner

T +90 212 339 00 12
E mete.yegin
@yeginciftci.av.tr

Itır Çiftçi
Partner

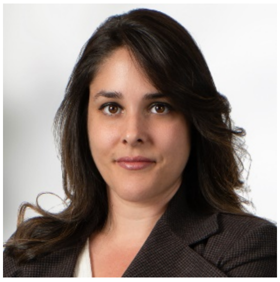
T +90 212 339 00 77
E itir.ciftci
@yeginciftci.av.tr

Sait Eryılmaz
Counsel

T +90 212 339 00 60
E sait.eryilmaz
@yeginciftci.av.tr

Kemal Aksel
Counsel

T +90 212 339 00 64
E kemal.aksel
@yeginciftci.av.tr



İrem Su
Senior Associate

T +90 212 339 00 08
E irem.su
@yeginciftci.av.tr

Deniz Göcük
Senior Associate

T +90 212 339 00 70
E deniz.gocuk
@yeginciftci.av.tr