

### EXTENSION OF LOANS FROM ABROAD

**This Briefing Note seeks to guide the residents of Turkey who provide foreign currency loans from foreign financial institutions and summarizes the major principle and exception as well as the restrictions applicable under Turkish legislation including taxation rules with respect to extension of foreign currency loans from abroad.**

For the purposes of protecting the value of Turkish currency and regulating capital movements arising from foreign lending, Turkish lawmakers have introduced certain rules and restrictions to Turkish residents.

#### **I. LEGAL FRAMEWORK SURROUNDING THE EXTENSION OF LOANS FROM ABROAD**

The need to extend loan from abroad, either directly or through the intermediation of a bank residing in Turkey, arises for private sector firms and especially for investors, when internal resources are inadequate and external sources are sought. Based on this need, the extension of loans from foreign financial institutions (“**FFI**”)<sup>1</sup> residing outside of Turkey is secured to satisfy the need for a necessary resource and to maintain the continuity of investments and products. Hence, Turkish legislation has established certain regulations to ensure the harmonisation of its internal regulations with international rules. This is done to ensure integrity in a global economy and to facilitate the utilization of external sources.

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<sup>1</sup> Foreign financial institution refers to any non-Turkish financial entity that extends loans in the ordinary course of a banking or similar business.

Pursuant to foreign exchange legislation applicable in Turkey, the following shall be considered within the scope of “foreign borrowing” for Turkish residents;

- i) Credit extended from FFIs directly residing outside of Turkey;
- ii) Credit extended from foreign branches of banks residing in Turkey;
- iii) Credit extended through syndication with the participation of Turkish banks and FFIs residing outside of Turkey.

The legislation that regulates rules and principles concerning the extension of credit from abroad is comprised of the following: i) Law No. 1567 regarding the Protection of the Value of Turkish Currency, which came into effect on 25 February 1930; ii) Decree No. 32 regarding the Protection of the Value of Turkish Currency, which came into effect on 11 August 1989 (“**Decree No. 32**”); and iii) Capital Movement Circular, published by Central Bank of Turkey (“**CBT**”) on 2 January 2002, subsequent to the publication of the Decree (“**Circular**”). In this framework, Decree No. 32 and the Circular are the primary pieces of legislation that set forth the regulatory principles for all operations relating to foreign exchange, the instruments representing foreign exchange, and the use and management of foreign exchange. In particular, the afore-mentioned legislation sets forth the restrictions and prohibitions applicable to Turkish residents while extending loans from abroad differentiated by the type of loans.

## **II. GENERAL RULE FOR UTILISATION OF CASH LOANS EXTENDED FROM ABROAD AND EXCEPTIONAL CASES**

### **A. Utilisation of Cash Loans in Turkey**

#### **i. General Principle under Decree No. 32**

Pursuant to Decree No. 32, Turkish residents<sup>2</sup> may freely borrow cash or non-cash loans in foreign currency or Turkish lira from FFIs residing outside of Turkey, without authorization from any authority or government, and may obtain such loan in kind and in cash from the same. However,

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<sup>2</sup> Turkish residents refers to real persons and legal entities who are domiciled in Turkey, including workers, members of independent professions, and independent businessmen and women.

Decree No. 32 clearly states that Turkish real persons are explicitly prohibited from obtaining foreign currency loans from abroad.

Decree No. 32 further stipulates that those who are granted cash loans by FFIs are in principal obliged to utilize such loans in Turkey by transferring the loan amounts through banks resident in Turkey (“**Intermediary Bank**”). Based on this condition, the transfer of principal repayments, interest payments and other payments of such loans are to be made through Intermediary Banks, regardless of whether such cash loan is extended either directly from such FFI or through Intermediary Banks. It is worth to note that this rule is not applicable for non-cash loans given that Decree No. 32 clearly sets forth that non-cash loans can be freely extended from FFIs without requiring the Intermediary Banks.

## ii. **Exception to the General Principle**

An exception to the afore-mentioned rule is delineated under the Circular. Based on this exception, if Turkish borrower will use such cash loan for its business engaged abroad and will not transfer the loan proceeds to Turkey for its investment in Turkey, Turkish borrower does not fall into the jurisdiction of Decree No. 32. As a matter of this exception, Turkish borrower shall make the repayment of this cash loan from its funds on abroad and shall not transfer the loan amount to Turkey.

Further to the exception stated hereinabove, Circular listed several other exceptions to the general principle as follows:

- Credit utilized from abroad is related to the business engaged abroad;
- Credit utilized from an export credit agency or credit guaranteed by an export credit guaranteed institution abroad and directly paid to the export company abroad;
- Credit utilized exclusively for the import of goods from development banks that provide cash financing and term financing instead of cash loans;
- Credit utilized for the import of ships to be purchased abroad.

## **B. Financing Models for Foreign Currency Cash Loans**

As per the Circular, foreign currency cash loans extended from FFIs, provided that such loans are disbursed through Intermediary Banks, shall be utilized by Turkish borrowers for the financing purposes defined below:

- Financing of exports, sales and deliveries assumed as export and currency savings transactions,
- Financing of transit trade,
- Financing of Turkish entrepreneurs engaged in business abroad,
- Financing of foreign trade,
- Financing of a business enterprise,
- Financing of investment in goods and services imports,
- Financing of ships to be purchased abroad, and
- Financing of investment in purchases of goods allowed by investment incentive certificates.

## **C. Loan repayment through Turkish Banks**

As explained under II.A (ii) of this Note, general rule of Decree No. 32 concerning transfer and utilization of foreign loans in Turkey is not applicable in the case that such foreign loans are extended directly from the FFI and such loan proceeds are not transferred to Turkey, utilized in Turkey or repaid through funds or sources of Intermediary Banks.

Given the above approach, if foreign loan is extended from abroad and transferred to Turkey through an Intermediary Bank, such loan proceeds will be repaid through such Intermediary Bank as well. However, if foreign loan is directly extended from abroad without transferring the loan amount to Turkey through an Intermediary Bank while such loan's repayment amount will be transferred to FFI through an Intermediary Bank, then such Intermediary Bank is obliged to control the loan documents of the Turkish borrower. The procedure is as follows:

- i. Turkish borrower may repay such loan through either the intermediary bank's own-source providing that equivalent Turkish Lira is deposited to the respective bank or through its own foreign exchange deposit account,

- ii.** Intermediary Bank, in the course of making the repayment of loans to a FFI, is obliged to obtain the loan documents from Turkish borrower so that to ensure whether the foreign loan amount is transferred to Turkey or not,
- iii.** In the event Intermediary Bank, while transferring the loan repayment to the FFI, finds out that the foreign loan is extended directly from abroad without intermediation of a Intermediary Bank and loan proceeds have not been transferred to Turkey as prescribed, such bank is obliged to notify the Undersecretariat of the Treasury,
- iv.** Following this notification, the Undersecretariat of the Treasury may initiate legal action against the relevant person(s)/entity(s) if there is a clear violation of legal regulations.

Notwithstanding the above, it is notable that Decree No. 32 and the Circular requires the following notifications to be made to CBT and Undersecretariat of the Treasury.

- Entities such as municipalities and public economic enterprises, are required to send their loan agreements in relation to foreign currency loans with a maturity of more than one (1) year, to the Undersecretariat of the Treasury with an External Financing Number within 30 days as of the date of loan agreement.<sup>3</sup>
- Save for the loans listed under II.A (ii) of this Note, information regarding the utilization and repayment of long-term or short-term cash loans with a maturity of more than one (1) year are required to be notified to the CBT.

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<sup>3</sup> Credit agreements of municipalities and their subsidiaries, other local authorities, public economic enterprises and their subsidiaries, institutions for whom more than 50% of their capital belongs to the public, foundations and universities, special budgeted public institutions, investment and development banks, institutions whose payment obligations are granted for projects within the framework of financing models such as build-operate-transfer, build-operate and transfer of operating rights and similar rights, agreements regarding long-term loans with a maturity of one year or more, except for the deferred payment form in imports, are required to be sent to the Municipality by the credit borrower with an External Financing Number within 30 day from the date of the agreement.

### III. TAXATION

With regard to the taxation of loans extended from abroad, the legislation brings significant benefits. Pursuant to the Stamp Tax Law, numbered 488, and the Act of Fees, numbered 492, any kind of guaranty, paper and commentary which is drawn up for the purpose of repayment and other provisions of loans extended from FFIs abroad is exempt from the stamp tax and fee. As for working capital loans extended from abroad, there is no Banking and Insurance Transaction Tax (“BITT”) obligation. However, the Resource Utilization Support Fund (“RUSF”) obligation is enforced at certain rates unless the maturity of the loan exceeds three (3) years.

### IV. RESTRICTIONS APPLICABLE TO REVOLVING LOAN FACILITIES

Pursuant to Turkish legislation, Turkish residents are not permitted to extend revolving loans from FFIs. This restriction was announced by the CBT on 6 May 2014.

In accordance with the Circular, the revolving loans are defined as follows:

- Loans extended with a maximum pre-approved credit limit,
- Loans extended within a loan availability period,
- Loan repayment and drawdown availability on any days during the term of the loan,
- Loans with primarily floating interest rates,
- Credit limit increases or decreases due to the drawdown and repayment of loans.

With this restrictive amendment, Turkish residents are prohibited from extending revolving loans from FFIs or any real person or entity resident outside of Turkey unless such facilities are employed for businesses engaged abroad, meaning that transfer, utilization and repayment of such facilities should not be taking place in Turkey.

## V. CONCLUSION

Turkish legislation currently in force does not constitute any restrictions on Turkish residents (save for real persons) to obtain cash or non-cash loans from FFIs. However, CBT, as a measure to control the flow of foreign currency, stipulates the repayment of foreign currency loans to be made through banks in Turkey. Ultimately, this legislation seeks to control the inflow and outflow of foreign currency under the auspices of credit utilization and credit repayment mechanism.

Turkish lawmakers tightened the lending criteria for Turkish residents in respect of revolving loans with an amendment that became effective in 2014 and prohibited Turkish residents to extend foreign currency cash loans from FFIs unless otherwise provided under the relevant legislation. With this restriction, lawmakers seek to prevent excessive borrowing of Turkish residents to a certain extent.

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