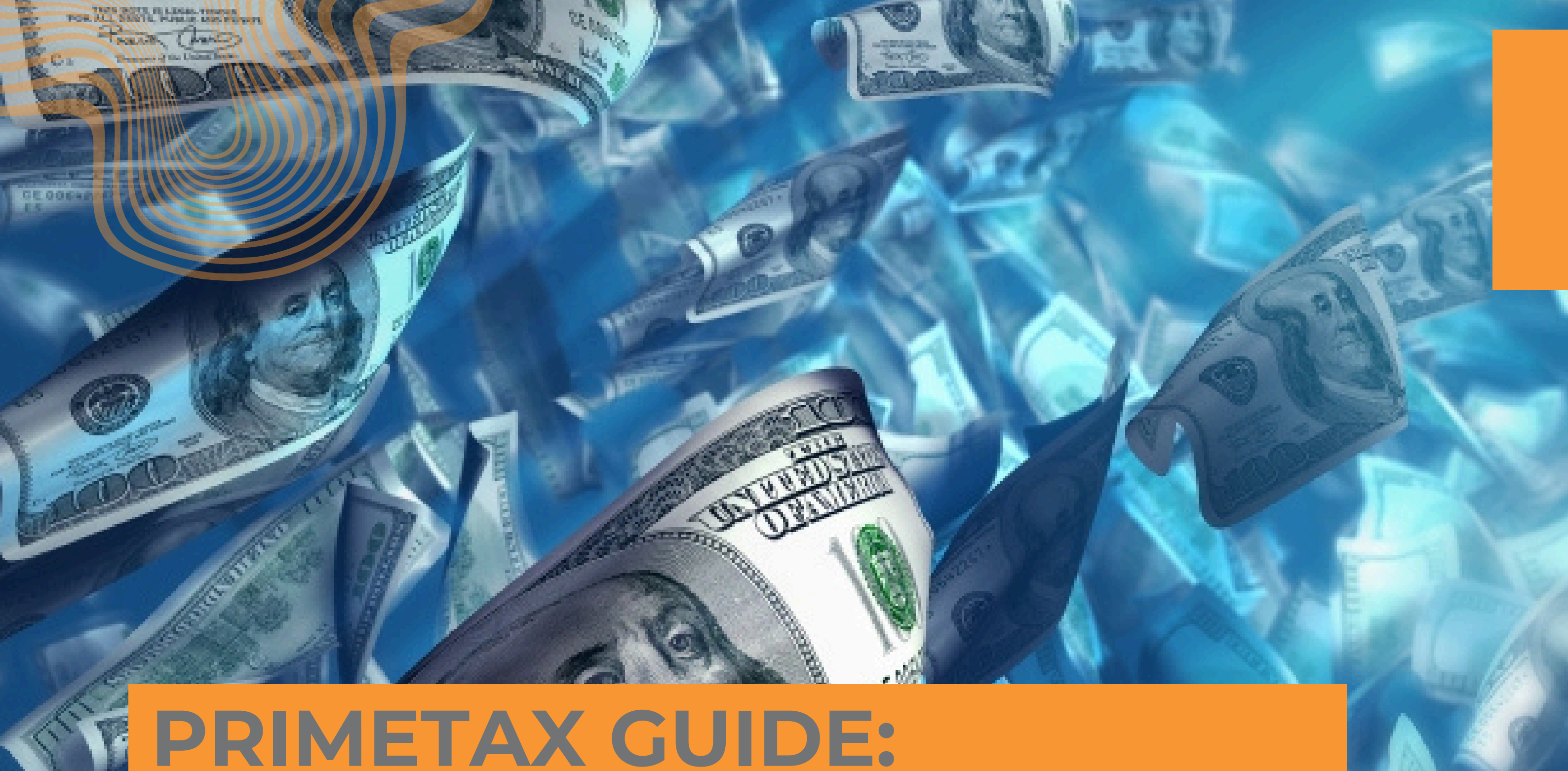

PRIMETAX GUIDE: CASH POOLING UNDER TURKISH LAWS

INTRODUCTION

Cash pooling is a financial arrangement designed to enhance liquidity management within corporate groups. Under this system, financially stable subsidiaries transfer their surplus cash to a designated "leader account," consolidating and centralizing the group's financial resources. These pooled funds are then allocated to affiliates needing liquidity, serving as an internal financing mechanism categorized as "intragroup external financial resources." This setup allows group companies to access funds from the leader account through intercompany loans.

By centralising cash balances, companies can lower costs associated with negative balances, minimize interest expenses on external loans, and maximize returns on surplus funds. Without cash pooling, a company needing capital may face high external borrowing costs, while another entity with excess cash may struggle to generate meaningful returns. Cash pooling effectively addresses these inefficiencies by optimizing financial resources across the group.

This system enables subsidiaries with surplus funds to support those with liquidity shortages, ensuring efficient internal cash management without reliance on external financing. As a result, corporate groups utilizing cash pooling can reduce their dependence on external funding by balancing deficits in some accounts with surpluses in others.

Types of Cash Pooling

1. Physical Cash Pooling:

This method involves regularly transferring cash balances from multiple accounts into a centralised account. It provides a direct and structured approach to managing group liquidity.

2. Notional Cash Pooling:

Unlike physical cash pooling, this approach does not involve actual fund transfers. Instead, account balances are virtually aggregated for interest calculation, allowing companies to benefit from balance netting without physically moving cash.

3. Multi-Currency Cash Pooling:

Designed for multinational corporations, this system helps manage liquidity across different currencies. It also mitigates foreign exchange risks and enables interest rate arbitrage opportunities.

By implementing a centralised cash management strategy, companies can enhance financial efficiency, reduce reliance on external financing, and optimise liquidity across the group. Cash pooling is particularly valuable for multinational corporations seeking to streamline financial operations across different jurisdictions.

LEGAL FRAMEWORK

Turkish law does not explicitly regulate cash pooling; however, specific legal provisions indicate that it may be permissible under certain conditions.

For instance, Decree No. 32 on the Protection of the Value of Turkish Currency ("Decree No. 32") and the Central Bank of Türkiye's Circular on Capital Movements ("Circular") allow Turkish legal entities to obtain and extend intercompany loans under defined circumstances. This suggests that participating in a cash pooling system could be legally viable in Türkiye.

Additionally, Article 386 of the Turkish Code of Obligations ("TCO") defines a loan agreement as a contract in which the lender commits to providing a sum of money or consumable goods to the borrower, who in turn agrees to repay an equivalent amount. Unless otherwise governed by Decree No. 32 or the Circular, intercompany loans are subject to general provisions of the TCO. Furthermore, Article 387 specifies that interest may be charged on commercial loan agreements even if not explicitly stated in the contract.

If a parent company wholly owns a subsidiary, Article 203 of the Turkish Commercial Code ("TCC") permits it to issue management directives, even if they result in financial loss if they align with the group's overall policies. However, Article 204 prohibits directives that could jeopardise the subsidiary's economic stability, endanger its existence, or lead to the loss of critical assets.

Additionally, Article 358 of the TCC restricts shareholders from borrowing funds from their subsidiary unless:

1. Their capital contributions have been fully paid, and
2. The subsidiary's profits and free reserves are sufficient to cover past losses.

If an intercompany loan leads to bankruptcy, Article 161 of the Turkish Criminal Code No. 5237 establishes potential criminal liability, including fraudulent or negligent bankruptcy charges.

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TAX LAW CONSIDERATIONS

Transfer Pricing

Under Article 13 of Corporate Tax Law No. 5520, financial transactions between a holding company and its affiliated entities must comply with the arm's length principle. Loan interest rates must reflect market conditions; otherwise, underpriced interest income may be considered transfer pricing and reclassified as a profit distribution. In domestic transactions, this applies only if a treasury loss occurs, whereas the treasury loss condition does not apply to international transactions.

Thin Capital

According to Article 12 of Corporate Tax Law, debt exceeding three times a company's shareholders' equity is classified as thin capitalisation. Interest and foreign exchange losses related to such borrowings are non-deductible for tax purposes. Loans provided under a cash pooling arrangement are also subject to this assessment.

Corporate Withholding Tax

If a company in Türkiye secures a loan from a related foreign entity that is not a financial institution, a 10% withholding tax must be applied to the interest paid. However, if a Double Taxation Avoidance Agreement exists between Türkiye and the lender's country, the agreement's provisions take precedence.

Value Added Tax (VAT)

Since interest payments on foreign loans are considered financing services, VAT must be applied under the reverse charge mechanism, per Article 9/1 of the VAT Law. The same applies to loans obtained from cash pools within Türkiye under financing arrangements.

Stamp Tax

Loan agreements issued by non-resident companies, except for banks or financial institutions, are subject to stamp tax at 0.948%.

Resource Utilization Support Fund ("RUSF")

Entities in Türkiye, excluding banks and financial institutions, must pay the RUSF at prescribed rates for foreign loans.

Rates for Turkish Lira (TL) Loans:

- 1% for maturities under 1 year
- 0% for maturities of 1 year or longer

Rates for Foreign Currency & Gold Loans:

- 3% for maturities under 1 year
- 1% for maturities between 1-2 years
- 0.5% for maturities between 2-3 years
- 0% for maturities of 3 years or longer

According to these maturity brackets, loans from foreign entities within a cash pooling system are subject to RUSF.

CONCLUSION

The cash pooling system is not explicitly regulated under Turkish laws. Consequently, general principles of Turkish law should be considered when assessing activities related to cash pooling. Additionally, since this system is rarely utilized in Turkey, the specific legal provisions applicable to cash pooling remain uncertain due to the absence of legal codification or judicial precedents.

Nevertheless, it is important to recognize that implementing a cash pooling system in Türkiye carries various legal implications. Therefore, companies should take into account the tax and legal principles outlined below before entering into a cash pooling agreement.

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