



PRIMETAX GUIDE: WHAT CONSTITUTES A “QUALIFIED FINANCIAL INSTITUTION”?

Introduction

In the realm of Türkiye's tax regulations, the designation of a "Qualified Financial Institution" (QFI) is a game-changer. It offers a gateway to substantial financial benefits and strategic advantages in international financing, particularly in the areas of withholding tax, VAT on interest payments for borrowings from abroad, and stamp tax purposes. Understanding and leveraging this designation can result in substantial tax savings.

What is a Qualified Financial Institution?

A Qualified Financial Institution is defined as:

- Foreign governments
- International institutions (e.g., European Bank for Reconstruction and Development (EBRD), International Finance Corporation (IFC))
- Foreign financial institutions authorised in their country of residence to grant loans to both related and unrelated entities

Key Benefits of Being a QFI:

1. Withholding Tax on Interest Payments:

- **General Withholding Tax Rate:** Non-resident corporations (those with limited tax liability) are typically subject to a 15% withholding tax on specific earnings, such as interest income, under Article 30 of Türkiye's Corporate Tax Law. However, interest payments to QFIs are subject to a 0% withholding tax rate, which provides significant tax savings. This reduction applies regardless of the lender's jurisdiction if the lender qualifies as a QFI.
- **Exceptions:** The withholding tax rate increases to 30% for payments to companies located in jurisdictions classified as tax havens, provided they do not qualify as a QFI. This means that if a company is not a QFI and is located in a tax haven, it will face a higher withholding tax rate, which could potentially increase its borrowing costs.

2. Exemption from Value Added Tax (VAT):

- **General VAT Applicability:** Typically, foreign payments are subject to a 20% reverse charge VAT, according to Türkiye's VAT Law. However, interest payments on loans obtained from QFIs are exempt from VAT, under the provisions of Article 17/4-e of the VAT Law. This exemption means that interest payments on loans obtained from Qualified Financial Institutions (QFIs) are exempt from VAT, thereby reducing the total borrowing cost.
- **Non-Financial Institution Loans:** If the loan is obtained from an entity that is not a QFI, the interest payments will be subject to the full 20% VAT.

3. Stamp Tax Exemption:

- **Loan Agreements:** Generally, stamp tax is applied at a rate of 0.948% on the monetary value stated in agreements, including loan agreements. However, loans granted by banks, foreign financial institutions, and international institutions are exempt from this stamp tax. This means that when a loan agreement is made with a QFI, the borrower is exempt from paying the stamp tax, making the process of securing loans more cost-effective.
- **Non-Exempt Loans:** If the loan is obtained from a non-financial institution (excluding banks or foreign financial institutions), the loan agreement will be subject to the full 0.948% stamp tax.

Summary of Key Benefits:

- **Interest Payments:** A 0% withholding tax applies to interest payments made to QFIs, regardless of the lender's location.
- **VAT:** Interest payments on loans from QFIs are exempt from VAT, reducing borrowing costs.
- **Stamp Tax:** Loan agreements with Qualified Financial Institutions (QFIs) are exempt from stamp tax, thereby reducing the overall cost of the loan documentation process.

These benefits make it financially advantageous for Turkish borrowers to seek loans from entities that qualify as QFIs, as they enjoy significant tax savings in multiple areas, including withholding tax, VAT, and stamp tax.

The Determination of a Qualified Financial Institution

Within the context of QFIs, while it's straightforward to identify entities like foreign governments and international institutions (e.g., the European Bank for Reconstruction and Development (EBRD) and the International Finance Corporation (IFC)), the phrase "foreign financial institutions authorised in their country of residence to grant loans to both related and unrelated entities" introduces a level of ambiguity. This definition seems somewhat elusive, leaving room for interpretation and raising questions about the precise criteria that determine eligibility.

The second paragraph of Article 32 of the CBRT Capital Movements Circular clarifies that the term "foreign credit institutions" refers to institutions authorised to provide financial resources under the laws of their home country, with lending loans being one of their primary activities. This means that to be considered a QFI, an institution must be authorised to provide financial resources in its home country, with lending loans being a significant part of its operations.

Additionally, in the third paragraph of Article 23, if a bank in Türkiye, acting as an intermediary for a loan obtained from abroad, is uncertain about the nature of the credit institution, the borrower will be required to confirm that the institution providing the loan is authorised to do so according to the relevant country's legislation. The borrower must then submit a document from the official authorities of the appropriate country, proving that the lending institution is authorised to offer credit. The Turkish diplomatic mission or economic consultancy in that country must verify this document.

That said, since this has yet to be tested in a tax audit, it remains unclear what type of documentation would be deemed sufficient by Turkish tax authorities to qualify as a QFI. We recommend that parties lending from abroad exercise caution when establishing themselves as a QFI for Turkish tax purposes. They should be prepared to gather as much legal documentation as possible, including their articles of association, formal letters from regulatory bodies, lending licenses, and any other supporting documents.
