



TABOĞLU & DEMİRHAN

SPIN-OFF UNDER TURKISH LAW

A. INTRODUCTION

Under Turkish law, the issues in relation to companies and commercial transactions are regulated by the Turkish Commercial Code (the “TCC”). However, the TCC does not include provisions concerning the spin-off of the companies even though it regulates the mergers and acquisitions of the companies. Previously, company spin-offs and share exchange rules of companies were briefly defined and several tax incentives were created for such transactions under Articles 38 and 39 of the Corporate Tax Law No. 5422 (the “Law No. 5422”). In accordance with Article 38 of the Law No. 5422, the Ministry of Finance and the Ministry of Industry and Trade have issued the Communiqué Regarding Principles and Procedures for Partial Spin-off Transactions of Joint Stock and Limited Liability Companies No. 25231 dated 16 September 2003 (the “Communiqué”) to regulate the principles and procedures concerning the partial spin-offs. In the year 2006, the new Corporate Tax Law No. 5520 (the “CTL”) has been adopted by the Turkish Parliament and published in the Official Gazette on 21 June 2006 and accordingly, the General Communiqué on Corporate Tax Serial No. 1 (the “General Communiqué”) has been issued by the Ministry of Finance and published in the Official Gazette on 3 April 2007. Although the CTL has repealed the Law No. 5422 with all its annexes and amendments, it is not clear whether the Communiqué is still in effect. However, in practice and as there is no other legal arrangement, the provisions of the Communiqué are still considered and applied as the primary source for the spin-off of the companies.

The aim of this article is to briefly summarize spin-off transaction under Articles 19 and 20 of the CTL, Articles 19 and 20 of the General Communiqué and the Communiqué.

Article 19 of the CTL and Article 19.2 of the General Communiqué defines two types of spin-off transactions that may be performed between the company transferring its assets and the other company acquiring such assets, namely full and partial spin-offs.

B. FULL SPIN-OFF

Full spin-off is the transfer of all assets, receivables and undertakings of a full fledged corporate tax payer company to two or more “existing” or “to be incorporated” full fledged tax payer companies through dissolution without liquidation process over such assets, receivables and undertakings’ book values in return for the acquisition of the transferee company’s shares by the existing shareholders of such transferor company.

C. PARTIAL SPIN-OFF

Partial spin-off is the transfer of real properties included in the balance sheet or shares in other entities held for at least two years and included in the balance sheet or production or service businesses of a full fledged tax payer company to an “existing” or “to be incorporated” full fledged tax payer company as capital in kind over their book values in return for the acquisition of the transferee company’s shares either by such transferor company or its existing shareholders.

The main difference between full spin-off and partial spin-off is that in the full spin-off the transferor company is subject to dissolution process without liquidation and loses its legal personality whereas in the partial spin-off, the transferor company does not go through a dissolution process and maintains its legal personality.

ATTORNEYS AT LAW

LEVENT CADDESI, No: 9 LEVENT, 34330, ISTANBUL, TURKEY

TEL: + 90 212 339 88 00 FAX: + 90 212 339 88 99

EMAIL: enquiries@taboglu.av.tr WEBSITE: <http://www.taboglu.av.tr>

1. COMMUNIQUÉ ON PARTIAL SPIN-OFFS

The Communiqué sets forth the principles, procedures, auditing and validity conditions for the realization of a partial spin-off transaction by and between/among the joint stock or limited liability companies. The Communiqué does not require that the spin-off should involve the same type of companies. Therefore, it may be asserted that a spin-off transaction may involve both joint stock companies and limited liability companies in a single transaction and it is not required for the parties of the spin-off transaction to be the same type of corporation.

2. PROCEDURE FOR PARTIAL SPIN-OFF TRANSACTIONS

Spin-off shall be performed by way of transferring of certain assets of the transferor company to the transferee company in the form of contributions of capital in kind. Accordingly, such assets shall be injected as capital to the transferee company over their book value through partial spin-off. The contributions of capital in kind by the transferor company in the transferee company shall be equal to the total value of the transferred assets shown in the accounting records of the transferor company. In case the contribution is exercised in a “to be incorporated company”, the provisions of the TCC and related legislation regarding the incorporation of a company shall apply. On the other hand, if the contribution is exercised in an “existing company”, then such company shall increase its share capital accordingly.

In return for the capital contribution realized in the transferee company either the transferor company or its shareholders acquire the shares of the transferee company. Since the Communiqué enables the shareholders of such transferor company to acquire the shares of the transferee company in return for the transferor company’s capital contributions, the capital of the transferor company is required to be adjusted to reflect such transaction. Therefore, a capital decrease in the transferor company equaling to the amount of the values of the shares to be acquired by the shareholders of the transferor company may need to be realized. However, it is possible to increase the share capital of the transferor company simultaneously with the share capital decrease through injection of cash or by use of reserves, which the company may freely utilize, provided that the accounts of the company in the balance sheet permit and such increase does not impair creditors’ rights.

However, it should be noted that according to Article 404 of the TCC, the shares issued in return for the capital contributions in kind to a company are not allowed to be transferred during a two-year period commencing from the date of the registration of the capital increase concerned.

3. STEPS OF PARTIAL SPIN-OFF TRANSACTIONS

According to the relevant provisions of the Communiqué, a spin-off transaction includes the following steps:

(a) Preparation of a spin-off agreement/plan

Pursuant to Article 9 of the Communiqué, the boards of directors of the transferor and transferee companies involving in the spin-off transaction are required to execute a spin-off agreement provided that such spin-off process is exercised through asset transfers to an “existing company”. In the event the spin-off is exercised through asset transfers to a “to be incorporated company” instead of an “existing company”, then a spin-off plan is required to be prepared by the transferor company. According to Articles 9 and 10 of the Communiqué, both the spin-off agreements and plans are required to be prepared in writing and involve particular provisions stated in the Communiqué.

(b) Auditing of the process by the experts appointed by competent court

As per Article 7 of the Communiqué, the balance sheet and the draft spin-off agreement/plan shall be audited by the experts appointed by the competent court in order to determine the value of the assets to be transferred to the transferee company through contributions of capital in kind.

(c) Conducting of the necessary capital increase and decrease procedures and approval of such spin-off transactions by the transferor and transferee companies

Pursuant to Article 11 of the Communiqué, subsequent to the preparation of the draft spin-off agreement/plan and the completion of the court process, the board of directors of the transferor and transferee companies shall convene their general assemblies (only the transferor company's general assembly shall be convened in case of a spin-off to a "to be incorporated company") and resolve on the approval of the spin-off agreement/plan and further proceedings related thereto.

In respect of the proceedings to be pursued in the transferee company: Should the contribution in kind is exercised in an "existing company", then such transferee company is required increase its share capital by amending its articles of association. Such increase may be held in the same general assembly where the spin-off agreement/plan is approved. In case there are privileged shareholders in the transferee company, the decision of the general assembly regarding capital increase is required to be approved by the privileged shareholders. On the other hand, if the assets of the transferor company are transferred to a "to be incorporated company", then no further procedure is required in respect of holding a general assembly in connection with such to be incorporated company. However, incorporation process shall be finalized simultaneously.

In respect of the proceedings to be pursued in the transferor company: If the shares of the transferee company will be acquired by the transferor company, then no further procedure is required in the transferor company in respect of a general assembly resolution resulting in the capital change. However, if such shares will be acquired by the shareholders of the transferor company instead of the transferor company itself, then a general assembly resolution concerning capital decrease in the transferor company is required since the assets of the transferor company are reduced in favor of the shareholders of such transferor company. Such capital decrease may be performed through an amendment to the articles of association of the transferor company in the same general assembly where the spin-off agreement/plan is approved. The capital decrease will be realized in compliance with Article 396 of the TCC. Furthermore, as mentioned above, it is also possible to perform a capital increase simultaneously with such capital decrease.

As per Article 397 of the TCC, in case of capital decrease, an announcement to the creditors of the transferor company should be made three times to inform them of the capital decrease and invite them to apply to the transferor company either for collecting or collateralizing their receivables. A similar procedure is also foreseen under Article 5 of the Communiqué. Accordingly, the transferor company shall perform due claims of the creditors and procure the approval of the creditors whose claims will be due in the future to the spin-off agreement/plan in accordance with Article 397 of the TCC and the Articles of Association of the transferor company for the completion of the spin-off proceedings.

(d) Transfer of the relevant assets to the transferee company subsequent to the registration of such transactions with the relevant Trade Registry

Spin-off shall be valid and finalized upon the registration of the minutes of the general assemblies with the Trade Registry. As per Article 12 of the Communiqué, the relevant procedural transactions concerning the actual transfer of the assets contributed in kind to the transferee company shall be realized within at most three months from the date of the registration of the transferor company's general assembly with the Trade Registry after the approval of the spin-off agreement/plan by the general assemblies of the transferor and transferee companies (only the transferor company's general assembly shall approve the spin-off plan in case of a spin-off to a "to be incorporated company"). On

the other hand, the shares of the transferee company shall be deemed to be acquired either by the transferor company or its shareholders upon the registration of the general assembly minutes of the transferee company concerning the capital increase by the transferee company.

D. TAX INCENTIVES OF SPIN OFF

According to Article 20 of the CTL, transactions that fall within the scope of the full or partial spin-offs shall be exempt from the relevant tax impositions set forth in the laws. Therefore, neither the transferor nor the transferee company shall pay any taxes for the gains accrued as a result of a spin-off transaction in addition to the exemption from the taxations in result of the execution of the spin-off agreements and documents and of the actual transfers of the assets.

E. CONCLUSION

The provisions of the CTL, the General Communiqué and the Communiqué basically regulate the spin-off of the companies under Turkish law. However, the need of a regulation within the scope of the TCC introducing rules on spin-off transactions has arisen since the primary aim of the CTL is to shape legal aspects of spin-offs in light of taxation issues and it is not clear whether the Communiqué is still in effect and, even it is considered to be in effect, it is a secondary source of law with respect to the TCC. Currently, the Turkish Parliament is discussing the new draft of the Turkish Commercial Code. The spin-off process is regulated under such new draft which is expected to be implemented in 2009.