

Turkey: Partial Spin Off Procedures Under Turkish Law

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Mergers and acquisitions of companies are regulated in detail under Articles 147 and 451 of the Turkish Commercial Code (the "TCC"). However, such rules have lacked the necessary regulatory moves concerning spin off transactions in Turkish corporate law theory. The expected initiative has been launched in 2001 and the Law No.4684, published in the Official Gazette on 3 July 2001, amending Articles 38 and 39 of the Corporate Taxation Law No. 5422. However, the determination of principles and procedures concerning spin off transactions have awaited the Communiqué on the Principles and Procedures of Partial Spin offs in the Joint Stock and Limited Liability Companies (the "**Communiqué**"), adopted by the Ministry of Finance and Ministry of Trade and Industry, published in the Official Gazette on 16 September 2003. Upon the adoption of the Communiqué, spin off transactions have boosted, yet revealing numerous controversial issues related thereto. Among all, the absence of assignment of debts from the transferor to the transferee company in a proposed spin off transaction is noteworthy by virtue of which the last legislative instrument governing the spin off transactions has been published, the new Corporate Taxation Law (specifically Article 19 and 20) No.5520 (the "**CTL**"), published in the Official Gazette on 21 June 2006. Article 19 of the CTL introduces two types of spin off transactions. Accordingly, a *full spin off* is defined as conveyance of all assets, receivables and undertakings of a full-fledged corporate tax payer company to a single or more to-be incorporated companies or existing full-fledged tax payer companies over such assets, receivables and undertakings' recorded values for the acquisition of the transferee company's shares by the existing shareholders of such transferor company. A *partial spin off* is described as conveyance of real property, shares of subsidiaries being hold at least for two years, production facilities and service enterprises in the balance sheet of a full-fledged tax payer company or a foreign incorporation's representative office in Turkey as capital in kind to a newly established or existing full-fledged tax payer company over their recorded values in return for the acquisition of the transferee company's shares either by such transferor company or the existing shareholders thereof. Yet, in case of production facilities' or service enterprises' conveyance, the debts of such facilities or enterprises are required to be transferred so as to maintain the enterprise integrity under the CTL. The difference between these two types is that in a full spin off transaction, the transferor company loses its legal personality whereas in a partial spin off transaction, the transferor company's legal personality remains unaffected.

Allocation of Properties and Transfer of Debts

According to the CTL and Communiqué, a partial spin off is exercised through the contribution of the sum of above mentioned properties (if applicable, deducted by the assigned debts with respect to the transferred property in case of production facilities' and service enterprises' conveyance) as capital in kind to a newly established or existing full-fledged tax payer transferee company. The allocated properties in question shall be transferred over their recorded values. Therefore, the contributions of capital in kind by the transferor company in the transferee company shall be the total value of the transferred assets (in case of production facilities and service enterprises, deducted by the debts to be transferred) set forth in the accounting records of the transferor company.

Acquirer of the Transferee Company's Shares

Under the Communiqué, the consideration to be allocated to the transferor company in return for the capital contribution in the transferee company is determined as transferee company's shares. It is set forth under the Communiqué that beside the transferor company, the transferor company's shareholders, if necessary, through exercising a capital decrease in the transferor company are also allowed to acquire the shares of the transferee company.

Roadmap of A Spin Off Transaction

According to the Communiqué, a spin off transaction may require the involvement of the execution of a spin off agreement/plan, auditing of the process by three expert witnesses appointed by competent courts, capital increase and decrease procedures, approval of spin off transactions by the transferor and transferee companies' general assemblies (in case of a Newco, sole approval by the transferor company) and finally actual transfer of the relevant assets or debts to the transferee company subsequent to the registration of such transactions with the relevant Trade Registry.

(a) Spin off Agreement/Plan: 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. However, in the event that the spin off is exercised through the asset transfers to a Newco instead of an existing company, than a "spin off plan" is required to be prepared by the transferor company. The spin off agreement or plan, as the case may be, is required to be prepared in writing and involves, among others, exchange ratios and the amount necessary to be paid in case of balancing, rights of the transferor company's shareholders, determination of the fiscal tables on which the spin off will rely, amount of the capital increase, the types of the shares to be given to the transferor company or its shareholders and nominal values and delivery procedures thereof.

(b) Expert Witness Audit: Spin off agreement and the balance sheet shall be audited by the expert witnesses appointed by the competent court for the determination of the value of the assets to be transferred to the transferee company through contributions of capital in kind.

(c) Approval of Spin off Agreement/Plan: Subsequent to the preparation of the spin off agreement/plan and completion of the auditing thereof, the transferor and transferee companies' general assemblies (solely the transferor company's general assembly in case of a spin off plan) will resolve on the approval of the spin off agreement. Furthermore, the transferor company shall perform due claims of the creditors and provide the creditors' approvals, the claims of whom will be due in the future in accordance with Article 397 of the TCC for the completion of spin off proceedings and their registration with the Trade Registry.

(d) Closing of the Spin off: Spin off shall be valid and finalized upon the registration with the Trade Registry.

Tax Remarks

According to Article 20 of the CTL, Article 17/4-c of the Value Added Tax Law, Article 123 of the Law of Administrative Charges and Table 2 of the Stamp Tax Law, the transactions that fall within the scope of the full or partial spin offs shall be immune from the relevant tax impositions set forth in such laws. Therefore, the transferor and transferee companies shall not pay tax for the income accrued from a spin off transaction in addition to the tax exemptions in result of the execution of the spin off agreements and documents and of the actual transfers of the assets.

Controversial Issues In Spin Off Transactions

The adoption of the principles concerning the assignment of debts as well as assets has overcome numerous problems and discussions in addition to the hesitations with respect to the partial spin off transactions. Therefore, debts relating to the assigned asset shall become the liability of the new acquirer of such assets, *i.e.* transferee companies, and the transferor companies will become no longer liable for the debts arising out of the assets which are transferred to a third person. The requirement concerning the approval of the transferor company's all creditors in a spin off transaction is deemed as extremely onerous. Yet, it will be more appropriate to require the approvals in proportionate with the amount of the transferred assets. For instance, in a spin off transaction comprising the transfer amounting to 10% of the transferor company's assets is likely to be deemed inappropriate in case all creditors' approvals (the receivables of whom exceed 10% of the transferor company's assets) are required. The transferred business of the transferor companies should be recognized as the continuance of such business in the transferee company. This principle will be extremely rewarding in respect of the transferor companies participating in state tenders, which are sought previous experience and company history in tender specifications.