Corporate Reorganisations 2019

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LEXOLOGY®
Getting The Deal Through

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Lexology Getting The Deal Through is delighted to publish the second edition of *Corporate Reorganisations*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on Belgium and Turkey.

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Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Lexology Getting The Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editors, Nick Cline, Robbie McLaren and Frederick Brodie of Latham & Watkins, for their continued assistance with this volume.

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Turkey

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Hergüner Bilgen Özeke

LEGAL AND REGULATORY FRAMEWORK

Types of transaction

1 What types of transactions are classified as 'corporate reorganisations' in your jurisdiction?

Mergers, demergers (spin-offs), and change of corporate type are the main types of corporate reorganisations. Share swaps, intra-group transfers of shares, liquidation of dormant entities, and squeeze-out of problematic minority shareholders could also be categorised as corporate reorganisations.

Rate of reorganisations

2 Has the number of corporate reorganisations in your jurisdiction increased or decreased this year compared with previous years? If so, why?

Despite a decrease in the number of corporate reorganisations with respect to the previous year, the value of corporate reorganisations has increased due to a few big-ticket transactions. And even though the number of reorganisations this year decreased compared with the previous year, the rising trend in corporate reorganisations we have seen for the last couple of years continues this year as well.

The reason the number of reorganisations decreased this year could be due to companies' priorities being focused more on financial restructuring than on corporate reorganisation.

Jurisdiction-specific drivers

3 Are there any jurisdiction-specific drivers for undertaking a corporate reorganisation?

The Turkish Revenue Administration and the Tax Inspectors Board have begun conducting tax audits regarding partial spin-off operations done in the past. They have changed their interpretation on tax-neutral spin-offs in such a way that not carrying the sub-accounts of the equity (paid-in capital, retained earnings, etc) from the spun-off company to the new company's accounting books in detail is considered a violation of the tax-neutral spin-off rules. These audits are ongoing and no case law has been released from the tax courts yet.

Structure

4 How are corporate reorganisations typically structured in your jurisdiction?

The most common examples of corporate reorganisations in Turkey are mergers and partial or full spin-offs. Corporate-type change from limited liability partnership to a joint stock corporation is another common corporate reorganisation structure.

Laws and regulations

5 What are the key laws and regulations to consider when undertaking a corporate reorganisation?

The Turkish Commercial Code No. 6102 published in the Official Gazette dated 14 February 2011 and numbered 27846 (TCC) is the main piece of legislation that sets forth the legal regime for corporate reorganisations. The tax aspects of corporate reorganisations are mainly governed by the Corporate Income Tax Law No. 5520 published in the Official Gazette dated 21 June 2006 and numbered 26205 (the CIT Law), the Value Added Tax Law No. 3065 published in the Official Gazette dated 2 November 1984 and numbered 18563 (the VAT Law) and the Stamp Tax Law No. 408 published in the Official Gazette dated 11 July 1964 and numbered 11751.

If the corporate reorganisation involves a publicly traded company or a company regulated under the Capital Markets Law No. 6362 published in the Official Gazette dated 30 December 2012 and numbered 28513 (CM Law), then the provisions of the CM Law and the relevant regulations and communiqués issued under the CM Law will also be applicable (including, without limitation, the Merger and Demerger Communiqué II-23/2 published in the Official Gazette dated 28 December 2013 and numbered 28865).

Reorganisations that involve companies operating in specifically regulated sectors are also subject to the relevant sector-specific legislation, such as Insurance Law No. 5684, Banking Law No. 5411, Electricity Market Law No. 6446, Turkish Petroleum Law No. 6491, Natural Gas Market Law No. 4646, Electronic Communications Law No. 5809, Law No. 4733 on Regulation of Tobacco, Tobacco Products and Alcohol Markets, Mining Law No. 3213 and their respective secondary legislation.

The Code on the Protection of Competition No. 4054 published in the Official Gazette dated 13 December 1994 and numbered 22140 (the Competition Law) and its secondary legislation are also applicable if the corporate reorganisation triggers a change of control and the turnover of the parties involved in such transaction is above the thresholds set under the competition legislation.

National authorities

6 What are the key national authorities to be conscious of when undertaking a corporate reorganisation?

The majority of corporate reorganisations are effective upon registration with the competent trade registry organised and supervised by the Ministry of Trade.

If the corporate reorganisation triggers a change of control and the turnover of the parties involved in the transaction exceeds a certain threshold set under the competition legislation, then the Competition Authority also becomes an important authority.

Corporate reorganisations involving publicly traded companies or companies subject to the CM Law are subject to the review and approval

of the Capital Markets Board, which is the governmental authority for capital markets in Turkey.

Corporate reorganisations involving companies in specifically regulated sectors are required to obtain prior approval from the relevant regulatory bodies depending on the type of corporate activity involved in the reorganisation. For example, banks and financial leasing and factoring companies require approval from the Banking Regulation and Supervision Authority for mergers, acquisitions, and spin-offs; insurance companies require approval from the Ministry of Treasury and Finance for mergers and acquisitions; electricity companies require approval from the Energy Markets Regulatory Authority (EMRA) for acquisitions triggering change of control, mergers, and spin-offs; natural gas companies require approval from EMRA for mergers; petroleum licence-holder companies require approval from the Ministry of Energy and Natural Resources for acquisitions triggering change of control and mergers; and telecom companies require approval from the Information and Communication Technologies Authority for acquisitions triggering change of control and mergers. Further, spin-offs of tobacco products manufacturing facilities are subject to the approval of the Tobacco and Alcohol Market Regulatory Authority. Thus, the secondary legislation of these authorities must be taken into account when undertaking corporate reorganisation.

Finally, the Ministry of Treasury and Finance, as the tax authority, must be considered in corporate reorganisations. Communication with the related tax office is very important regardless of whether or not the corporate reorganisation is tax neutral.

KEY ISSUES

Preparation

7 What measures should be taken to best prepare for a corporate reorganisation?

Before corporate reorganisation, it is essential to make a structure-related analysis to see if the needs for reorganisation can be matched with the type of organisation planned, as well as an assessment of the possibility of satisfying the requisite minimum corporate requirements for the relevant reorganisation transactions (shareholders' approval, board of directors' approval, and in some cases creditors' approval).

Legal, tax, technical, and financial due diligence, especially for accounting books, financial tables, tax returns, contracts, employment matters, licences, and permits, must be done to determine the optimum conditions precedent for a proper reorganisation and to understand and manage the implications of the reorganisation. During this due diligence stage, any regulatory appraisal work or financial table confirmation work conducted by sworn-in certified public accountants or certified public accountants will also be simultaneously undertaken to prepare the underlying documentation for the corporate approval processes.

Most of the reorganisation work requires appraisal of the companies involved, so an appraisal by independent experts should be organised.

Employment issues

8 What are the main issues relating to employees and employment contracts to consider in a corporate reorganisation?

Corporate reorganisations may be categorised as 'transfers of workplace' under Turkish law. As per article 178 of the TCC and article 6 of the Turkish Labour Code (TLC), unless employees object, employment agreements executed with the transferor company will be transferred to the surviving or the acquiring entity together with all of the rights and obligations that have accrued until the date of transfer. Thus, the transferor ceases to be liable for any employment-related rights that arise after the date of transfer and the surviving or the acquiring entity becomes liable from the start date of the initial employment. For liabilities that accrued prior to the reorganisation, the transferor and the acquiring entity will be held jointly liable for two years as of the date of reorganisation, after which the transferor company (if it still exists) will cease to be liable. However, the above-mentioned two-year liability limit will not apply to joint liability regarding severance pay. The transferor and the surviving or the acquiring entity will be held jointly liable for severance pay without a time limit. The issue of joint liability is not applicable in cases where one of the entities is dissolved after reorganisation and instead the surviving entity will have sole liability.

In practice, sometimes the parties involved prefer to arrange a net cut-off for pre and post-organisation liabilities relating to employees (in cases of merger through new company formation) and instead opt for terminating the existing employment agreements with the employees of the transferor company (by fully paying the requisite termination rights) and executing new agreements between these employees and the acquiring entity. Employment agreements should be terminated upon payment of all employment-related accrued rights that become due on the date of termination (eg, notice pay, severance pay, and annual paid leave). Following termination, the transferor will fully pay the termination-related rights and in return will obtain a release letter from the employee stipulating that he or she does not have any outstanding receivables from the employer as of the date of reorganisation. Such arrangements mostly cover the monetary aspect of the rights accrued up until the date of reorganisation; however, even though legally a new contract is executed with the new acquiring entity, the date of this contract will not reset the term of the employee's employment, and while calculating employment-related rights of the employee in the future, the term with the initial employer must be taken into consideration. Furthermore, the terms of the new employment contract should not aggravate the previous employment terms, as the new employer may only amend such terms with the written consent of the employee.

Corporate reorganisation alone does not grant the relevant parties involved the right to terminate employment agreements. However, if the address of the workplace, the title, salary, or any other material employment condition is changed or otherwise affected owing to reorganisation, such change will necessitate the employee's consent, which must be provided within six days following the written notification of the change to the employee by the employer. In the absence of the employee's consent, the employee will not be bound by such change and the employer may terminate the employment agreement for just cause by serving a written notification to the employee stating that the change has been made on valid grounds. As per court precedent, a valid ground for termination should originate from the employee or business requirements of the employer and such change should be one that the employee is reasonably expected to accept. The employee is not directly entitled to terminate their employment contract in the case of change of material work conditions under the TLC; however, 'non-implementation of work conditions' is stated as just cause for an employee to terminate his or her employment agreement. Under article 24 of the TLC, the employee may assert the change of material working conditions as a valid ground for termination. Turkish courts have an employee-friendly approach when analysing the existence and appropriateness of just cause and valid cause.

Also, as per article 5 of the TLC, the employer has the obligation to observe equality between employees who are of the same status unless there is a valid reason to differentiate their treatment. Therefore, in mergers, the employment terms of the transferred employees should be reviewed to determine if there are any differences in the employment terms of the existing employees of the merged entity in light of this equality principle. In such case, the employee with the lower conditions should be granted additional benefits.

Finally, the status of collective bargaining agreements (CBA) in transfers of business is regulated under the unions and Collective Bargaining Law No. 6356 published in the Official Gazette dated 7 November 2012 and numbered 28460 (the Collective Bargaining Law). By analogy, the transfer of business-related provisions is applicable to corporate reorganisations. If only one of the entities in a reorganisation has a CBA, then the other entity will also become bound by the terms and conditions of the same CBA following reorganisation. However, if all of the entities involved in a corporate reorganisation are party to a CBA and if all workplaces are operating in the same line of business, then the CBA executed by the surviving entity or the acquiring entity will be treated as an employment agreement. Nevertheless, employees are entitled to benefit from the CBA that provides a broader set of rights and benefits to them.

9 What are the main issues relating to pensions and other benefits to consider in a corporate reorganisation?

Under Turkish law, fringe benefits, including pensions, are considered part of the employee's salary, notwithstanding such benefit being clearly stated in an employment agreement or established through consistent workplace practice. As explained in question 8, in the case of transfer of employment agreements through corporate reorganisation, the terms and conditions of an existing employment agreement should remain intact and should not be amended to the detriment of the employee without his or her written consent (see question 8 for detailed information on the termination rights that will arise from amendment of the material terms of an employment agreement). Therefore, the reorganised company has an obligation to retain the benefits that were available prior to corporate reorganisation. The transferor and acquiring entity will be held jointly liable for two years for the benefits accrued up until the date of corporate restructuring, after which date the liability of the transferor (if the company still exists) will cease.

Financial assistance

10 Is financial assistance prohibited or restricted in your jurisdiction?

For corporate reorganisations involving or otherwise resulting in a company acquiring its own shares, article 380 of the TCC imposes a financial assistance restriction. According to this clause, any legal transaction related to provisions for advance payment, loan, or security interest by a company to a third party made for such third party to acquire the company's shares will be deemed null and void. This financial assistance restriction will not apply to transactions performed by banks or financial institutions in their ordinary course of business, and transactions whereby an advance payment, loan, or security is provided to the company's or its subsidiaries' employees for the purpose of such employees' acquisition of the company's shares. Nevertheless, if these exempt transactions reduce the reserves of a company below the levels specified in the relevant laws and the company's articles of association or prohibit the company from putting aside the necessary statutory reserves, even such exempt transactions will also be deemed null and void.

Furthermore, debt push-down of interest expenses in leveraged buyouts (LBO) is also problematic because, despite the absence of a clear provision in Turkish tax legislation, in practice the tax authority considers these expenses not tax-deductible.

Common problems

11 What are the most commonly overlooked issues or frequently asked questions in a corporate reorganisation?

The following are examples of main issues overlooked in corporate reorganisations: structure-wise and liability-wise, negative equity (ie, eroded share capital) or technical insolvency and the availability of distributable reserves (especially in demergers); contractual-wise, change-of control provisions; and business-wise, strategies for maintaining the integrity of the business in partial spin-offs.

Article 376 of the TCC and article 179 of Turkish Execution and Bankruptcy Code No. 2004 stipulate that if the share capital of a company is below certain thresholds owing to the accumulated losses of past exercises, the company is deemed to be technically insolvent or bankrupt. In a merger, the other merging entity must have sufficient net assets to absorb this accumulated loss and top up the negative equity, otherwise the merger cannot be accomplished. Negative equity also imposes several obligations on the board of directors to take certain corporate actions which vary depending on the level of eroded equity, from half to two-thirds or more, and range from notifying and informing the shareholders and getting approval for remedy actions to resolving upon capital decreases or increases (with cash injections) and preparing interim balance sheets prepared per business on a going concern basis and per actual sale value of assets, etc.

For tax-neutral partial spin-offs, the integrity of the production or service business must be maintained in the new company. Therefore, the assets and liabilities of the production or service business cannot be spun-off separately in tax-neutral corporate reorganisations.

Maintaining proper continuity of contractual ecosystems of reorganised entities through pre-reorganisation due diligence, and introducing proper checks and balances in order to determine and manage change of control approval or simple pre-notifications out of courtesy, as well as managing conflicts of interest situations, are also sometimes overlooked in corporate reorganisations.

ACCOUNTING AND TAX

Accounting and valuation

12 How will the corporate reorganisation be treated from an accounting perspective? How are target assets and businesses valued?

Corporate reorganisations are treated as share sales, spin-offs, or share swaps. If the assets and liabilities are transferred with their book values and the other requirements in corporate income tax law are fulfilled, the spin-off is tax neutral. Regardless of whether or not the spin-off is tax neutral, the target business is valued at the fair value (market price) for share distribution after the reorganisation.

Accounting firms and financial advisors are involved for the accounting and valuation of the companies.

Tax issues

13 What tax issues need to be considered? What are the tax implications of carrying out a corporate reorganisation?

The CIT Law regulates the tax aspects of corporate reorganisations. According to article 18 of the CIT Law, profit due to a merger is subject to corporate tax. On the other hand, articles 19 and 20 stipulate the conditions of tax-neutral corporate reorganisations.

In this context, for acquisitions, if the acquiree and the acquiror are both Turkish residents (have their legal or administrative centre in Turkey) and the assets and liabilities of the acquiree are transferred to the acquiror's accounting books on their book values, and the other

conditions stipulated in article 20 of the CIT Law are fulfilled, the acquisition will be corporate tax neutral. Corporate-type changes under these same circumstances are also considered tax neutral.

For full spin-off operations in which a full taxpayer capital company (limited liability partnership or joint stock corporation) transfers all of its assets and liabilities to two or more existing or newly established full taxpayer capital companies and the shares of these existing or newly established companies are given to the shareholders of the spun-off company, the full spin-off will be corporate tax neutral provided that other conditions stipulated in article 20 of the CIT Law are fulfilled.

For partial spin-off operations in which a full taxpayer capital company or a foreign capital company's Turkish branch transfers its real estate, subsidiaries, affiliates held for more than two years, production, or service businesses to an existing or newly established full taxpayer capital company and the shares of this existing or newly established company are given to either the spun-off company or its shareholders, this partial spin-off will be corporate tax neutral provided that the other conditions stipulated in article 20 of the CIT Law are fulfilled.

For share swap operations in which a full taxpayer capital company acquires administrative control and the share majority of another capital company and transfers its shares to the shareholders of the acquired company in return, this share swap will be corporate tax neutral provided that other conditions stipulated in article 20 of the CIT Law are fulfilled.

According to article 17 of the VAT Law, the delivery of share certificates and shares of other participation investments held for more than two years are exempt from VAT.

According to the Stamp Tax Law, the papers related to corporate reorganisations performed according to articles 19 and 20 of the CIT Law are exempt from the stamp tax.

Accounting firms, sworn-in certified public accountants, and fiscal advisors are to be involved for tax-neutral corporate reorganisations.

CONSENT AND APPROVALS

External consent and approvals

14 | What external consents and approvals will be required for the corporate reorganisation?

If a change of control happens in a corporate reorganisation and the shareholder or management identity is important, commercially or financially, for the business stakeholders – such as clients, lenders, or suppliers, their approval may be required. In case of contractual requirements for change of control approval, such approval should be obtained prior to the corporate reorganisation. Mergers and demergers also involve corporate approval both at the board of directors and shareholders levels as well as no objection from creditors (an objection will necessitate sufficient security to be provided).

Depending on the sector, approval from the regulatory and supervisory authorities is required before the corporate reorganisation (see question 6 for the details of the regulatory approvals required).

Furthermore, if the corporate reorganisation results in a change of control and exceeds the turnover threshold defined under the Competition Communiqué, the Turkish Competition Authority's approval is required.

For tax-neutral corporate reorganisations, the CIT Law requires the tax office to be kept duly informed and some forms and declarations must be filled in.

Internal consent and approvals

15 | What internal corporate consents and approvals will be required for the corporate reorganisation?

According to the TCC, the general assembly of shareholders' approval of the relevant documents and agreements, such as merger or demerger agreements or plans and a report prepared and executed by the company's board of directors, is required. For company-type changes, the general assembly of shareholders' approval is also required for the change of type plan and report prepared by the board of directors. Unless a higher quorum is set in their respective articles of association, a qualified majority is sought for approval in the general assembly of shareholders.

ASSETS

Shared assets and services

16 | How are shared assets and services used by the target company or business typically treated?

There is no specific rule for the assets and services used by the target company or business. It depends on the agreement between the parties in the corporate reorganisation. On the other hand, for tax-neutral spin-offs, the integrity of the production or service business must be maintained by the new company.

Transferring assets

17 | Are there any restrictions on transferring assets to related companies?

There are no restrictions on transferring assets to related parties. In any such transfer, transfer pricing rules must be carefully considered. According to article 14 of the CIT Law, the prices in related-party transactions must be on arm's-length basis, otherwise the difference between the applied price and the arm's-length price is not tax deductible and may be deemed disguised profit distribution which may trigger withholding tax.

18 | Can assets be transferred for less than their market value?

The assets can be transferred for less than their market values; however if the transaction occurs between related parties, any negative deviation from market price at an arm's-length basis will trigger application of the transfer pricing rules explained in question 17.

FORMALITIES

Date of reorganisation

19 | Can a corporate reorganisation be backdated or deemed to have already taken place, for example from the start of the financial year?

According to the TCC, corporate reorganisations become legally effective upon registration with the competent trade registry. Therefore, it is not possible to backdate corporate reorganisations.

Documentation

20 What documentation is required in a corporate reorganisation?

Mergers and demergers require:

- a merger or demerger agreement to be executed by the board of directors, which should be approved by the general assembly of shareholders;
- a merger or demerger report to be issued by the board of directors; and
- an audit report for companies that are subject to independent audit.

A change of corporate type requires:

- a conversion plan (which also includes the new articles of association of the company) to be issued by the board of directors and approved by the general assembly of shareholders;
- a conversion report to be issued by the board of directors and approved by the general assembly of shareholders; and
- an audit report for companies that are subject to independent audit.

In addition, if the companies in question are operating in a sector that is governed by sector-specific regulations (eg, banking, energy sectors), approval should be obtained from the relevant governmental bodies, and ultimately the corporate approvals mentioned above (general assembly resolutions, etc) should be registered with the trade registry.

For tax-neutral corporate reorganisations:

- in acquisitions, the acquiror and the acquiree jointly sign and deliver the CIT return of the acquired company to its tax office, and the acquiror gives written commitment for the tax dues (past or future) and other tax liabilities of the acquired company;
- in full spin-offs, the spin-off and the new company jointly sign and deliver the CIT return of the spun-off company to its tax office, and the new companies give written commitment for the tax dues (past or future) and other tax liabilities of the spun-off company.

Representations, warranties and indemnities

21 Should representations, warranties or indemnities be given by the parties in a corporate reorganisation?

There are no mandatory representations, warranties or indemnities to be given by the parties to a corporate reorganisation under Turkish law. However, unless a reorganisation is fully intra-group reorganisation, it is common to obtain certain representations, warranties, and indemnities from the parties to corporate reorganisation.

Assets versus going concern

22 Does it make any difference whether assets or a business as a going concern are transferred?

The transfer of business is regulated both under the TCC and Turkish Code of Obligations No. 6098 (TCO). Especially from the TCO's perspective, the distinction between an asset transfer and a business transfer is important for liability sharing. According to the TCO, transfers of assets are treated as contractual transactions and therefore do not normally require any notification or registration. However, if such transfer relates to a significant portion of assets or a specific business or business unit of a company, the relevant provisions of the TCO regulating the business transfer will apply. The test to determine the existence of a business transfer is made by evaluating whether or not the sale of assets will affect the integrity and continuation of the business or company or continuation of a specific business unit. If the response to that question is positive, then such asset sale will be deemed a business transfer and will be subject to the registration and documentation requirements set forth under the TCO. Furthermore, in a business transfer, the assets of the business and the liabilities pertaining to such assets must be transferred, otherwise they will be deemed transferred by operation of law.

Pursuant to article 408 of the TCC, approval from the general assembly of shareholders is required before the major asset sale or transfer. If the company is subject to the CM Law, then a major transfer of assets is defined as a significantly qualified transaction under article 23 of the CM Law. Valuations of these assets by independent experts and public disclosures are required by the secondary legislation.

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Type of entities

23 Explain any differences between public, private, government or non-profit entities to consider when undertaking a corporate reorganisation.

The general corporate reorganisation provisions under the TCC apply to commercial companies, foundations and associations that operate a business to fulfil their goal of incorporation, as well as institutions and organisations that are established by the government, special provincial administration, a municipality or a borough, or other public legal entities for the purpose of commercial operation or to operate under private laws pursuant to their laws of incorporation.

In respect of state-owned entities, Decree Law No. 233 regarding State-Owned Enterprises (Decree Law No. 233) states that, apart from the provisions of this Decree, state-owned enterprises shall be subject to private law provisions. However, unlike private law entities, corporate reorganisation of state-owned entities is subject to the approval of a governmental body, namely the High Planning Council, a non-permanent body composed of the President of the Republic of Turkey and the ministers designated by the President. However, pursuant to the Circular numbered 2018/3 published in the Official Gazette on 2 August 2018, the duties of the High Planning Council have been transferred to the President.

Post-reorganisation steps

24 Do any filings or other post-reorganisation steps need to be taken after the corporate reorganisation takes place?

The TCC requires the following filings to be made following corporate reorganisation:

- notification to the trade registry for registration of transfer of shares; and
- notification to the trade registry for registration of sole shareholder.

Moreover, additional actions (such as notices to creditors) may be required depending on the facilitated corporate reorganisation mechanism.

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