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CHINA OUTBOUND INVESTMENT SPECIAL FOCUS 2019
TURKEY

A natural gateway for Asian exports

Ümit Hergüner, Senem Denктаş and Deniz Tuncel of Hergüner Bilgen Özeke examine the environment for Chinese investment into Turkey and the efforts the two countries have been making to develop cooperation, most recently in nuclear energy and dispute resolution

Turkey's imports from China amounted to \$20.71 billion in 2018 and China is among Turkey's top trade partners, despite the slight decrease in trade in 2018 compared to the preceding five years. Turkish exports to China amounted to about \$2.9 billion in the same period, resulting in a substantial trade imbalance in favour of China. Policymakers of both countries seem to recognise the importance for Chinese direct investment into Turkey to work towards an equilibrium yielding greater benefits for both economies.

The project that seems to be stirring up most excitement is the Belt and Road Initiative (BRI). One of the project routes goes through Turkey, a natural gateway for Asian exports with its proximity to European markets, as did the historical Silk Road. In 2015, Cosco Pacific of China acquired majority shares in Kumport, one of the largest ports in Turkey with substantial container handling capacity to serve the industrialised area surrounding Istanbul. This \$940 million acquisition was the largest Chinese direct investment into Turkey to date and complements the 21st Century Maritime Silk Route.

In 2018, Alibaba Group acquired majority shares in Trendyol in what was the largest Turkish e-commerce transaction to date. Chinese direct investment has also targeted the energy, mining, banking, technology, agriculture and tourism sectors. Industrial and Commercial Bank of China (ICBC) recently lent \$350 million to Turkish Eximbank. ICBC had previously participated in the bond issuance for financing the Elazığ City Hospital PPP project, a landmark social infrastructure project that is part of Turkey's large pipeline of healthcare PPP projects. China CAMC Engineering, together with its local partner, recently won the tender for the design, supply and installation of the Lake Tuz underground natural gas storage expansion project sponsored by the state-owned natural gas transmission company of Turkey.



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Turkey has taken important steps in recent decades to encourage foreign investors in a non-discriminatory manner. The Foreign Direct Investments Law paved the way by removing minimum investment requirements and facilitating the issuance of residence and work permits to foreign employees. Turkey favours Chinese investment, as China is Turkey's third trade partner globally (after Russia and Germany) and the largest source of imports to Turkey.

In 2016, Turkey ratified the Agreement Between the Government of the Republic of Turkey and the Government of the People's Republic of China for Cooperation in the Peaceful Uses of Nuclear Energy. Turkey is planning to commission its first nuclear power generation unit in Akkuyu by 2023, to be followed by nuclear power plants to be built in Sinop and a third plant planned in the Kırklareli province located in north-west Turkey. China is a strong candidate to invest in the construction and operation of these nuclear power plants in Turkey, which are planned to account for 15% of the total power generation capacity by 2030.

Significant Chinese investment in renewable energy, transportation infrastructure, mining, the automotive sector and logistics are also expected in the near future. Chinese investors may also benefit from Turkish businesses' resources and experience in markets such as the Middle East, Africa and the CIS as a co-investor with a strong track record.

Investment approval

In principle, there is no approval requirement for foreign investors. Foreign investors and local Turkish investors are treated indiscriminately, apart from in a few regulated sectors where foreign control is restricted (further explained below).

There is a national security screening process applicable to the acquisition of real property by Turkish companies controlled by foreign shareholders in proximity to certain designated areas (for instance, military forbidden zones, military security zones and private security zones). The review must be concluded within 60 days following filing for the same. A limited number of regulated sectors are also subject to certain foreign control or ownership restrictions. The most notable examples are domestic shipping, broadcasting and aviation industries.

The only instance of a golden share in a




Ümit Hergüner
*Senior partner, Hergüner Bilgen
Özeke Attorney Partnership
Istanbul, Turkey*
T: +90 212 310 18 00
E: uherguner@herguner.av.tr
W: www.herguner.av.tr

About the author
Ümit Hergüner is the founder and senior partner of Hergüner Bilgen Özeke Attorney Partnership, which was founded in 1989 and remains a leading independent, full-service law firm in Turkey. Ümit leads every major matter involving joint-ventures; private equity; acquisitions; restructuring; corporate governance; franchising & distributions; contract management; public tenders; procurement; government relations; government contracts; defence contracts; and public international law.

After graduating from Istanbul University Law School in 1979, he won a Fulbright Scholarship in 1983 and earned LLM degrees from American University Washington College of Law and the University of Virginia School of Law. He is on the advisory board of the International Relations & European Union Centre at the Union of Turkish Bar Associations and is a founder and former president of the Istanbul chapter of the Washington DC-based International Law Institute. He is a former president and current advisory board member of the Corporate Governance Association of Turkey.

privatised entity is Turk Telekom, the telecoms company that enjoys a natural monopoly over landline and broadband internet services due to its ownership of the infrastructure. The golden share grants the Turkish treasury negative control rights despite its minority shareholding stake. The government also has monopoly rights in



Senem Denktas
*Partner, Hergüner Bilgen Özeke
Attorney Partnership
Istanbul, Turkey*
T: +90 212 310 18 00
E: sdenktas@herguner.av.tr
W: www.herguner.av.tr

About the author
Senem Denktas has been with the Hergüner Bilgen Özeke for over 20 years. She has significant experience in public-private partnerships; concessions agreements, privatisations, inter-government agreements (IGAs) and host government agreements (HGAs); joint-ventures; private equity; acquisitions; restructuring; intellectual property; data protection; and cyber-security. Senem also practices in the area of technology, media and telecommunications law, including the regulation and policy of telecommunications, media, the internet and e-commerce.

Senem received her bachelor of laws from Istanbul University School of Law in 1996 and her master of laws in international business law from the London School of Economics and Political Science in 1998. She also served as the international director of institutional relations for the European Law Students' Association (ELSA) in Brussels. Senem is a member of the Istanbul Bar Association and ELSA.

certain other businesses, such as the exploration and production of boron resources.

As for investment approvals under competition law, the independent regulatory authority that oversees competition clearance is the Turkish Competition Authority (*Rekabet Kurumu*) (TCA). All decisions by the Competition Board, the decision-making



Deniz Tuncel

*Partner, Hergüner Bilgen Özeke
Attorney Partnership
Istanbul, Turkey*
T: +90 212 310 18 00
E: dtuncel@herguner.av.tr
W: www.herguner.av.tr

About the author

Deniz Tuncel has been with Hergüner Bilgen Özeke for 10 years, where he is a partner in the corporate, M&A and energy practice groups and generally advises as lead transactional counsel for cross-border mergers, acquisitions and joint-ventures. Having joined the firm in 2009, Deniz was seconded to the Tokyo office of Japanese legal giant Mori Hamada & Matsumoto in 2014. His major work has included cross-border energy projects and large-scale natural gas pipelines connecting eastern gas fields to Europe via Turkey.

Deniz is a graduate of Istanbul University and received his first LL.M degree from Istanbul Bilgi University and a second LL.M degree from Harvard Law School. He is a member of the supervisory board of the Istanbul chapter of the International Law Institute (ILI) and of the editorial board of the Turkish Commercial Law Review. He is also a member of the Turkey-China Business Council of the Foreign Economic Relations Board (DEIK) of Turkey.

organ of TCA, are subject to judicial review by administrative tribunals if challenged.

M&A transactions that cause a change in control and have a significant impact on the product or services markets are subject to the approval of the TCA, if the relevant parties' turnovers exceed certain thresholds. Transactions are to be notified to the TCA before the ultimate transfer of control, which is usually made after signing and prior to closing of the contemplated share or asset transfer. After the merger clearance filing has

been submitted, the TCA has 30 days (at Phase I) either to approve the transaction or to issue a letter of preliminary objection, in which the Competition Board will declare that the proposed transaction will be investigated further in a Phase II review. In Phase II, the case handlers are equipped with full investigative powers, including the ability to make on-the-spot inspections. Phase II can last six months from its inception and can be extended for an additional period of up to six months.

Any supplementary information requested by the TCA suspends the 30-day period and the clock restarts upon submission of the requested information. In practice, this procedure to ask for additional information or documents is used quite often by the TCA, especially when the case handlers consider that the case does not necessarily need a Phase II review, but that more time is needed to complete the evaluation. Where the TCA does not take any action concerning a transaction within 30 days after the submission of the complete notification, the proposed transaction is deemed to be approved by the TCA. A case that does not raise significant competition concerns takes six to eight weeks to pass through the TCA's review.

There are pre-closing regulatory approval requirements for change of shareholding structure in companies active in certain sectors, including: banking; financial services; energy; oil and gas; mining; insurance; broadcasting; aviation; and telecommunications. However, these approval requirements are applicable to both foreign and local investors.

Investment techniques

Chinese investors can establish a joint stock corporation (JSC) or a limited liability partnership (LLP) or acquire shares in an existing JSC or LLP, as the liability of shareholders is limited to their capital contribution in these frequently used limited liability company forms. Legal representatives of both LLPs and JSCs (board members of JSCs and managers of LLPs) and shareholders of LLPs can be held liable for unpaid public debts (such as tax, social security premiums of employees or fines owed to public authorities) of the company that cannot be collected from the company. This potential shareholder exposure in the case of LLP leads the majority of investors to opt for the JSC.

JSCs and LLPs can be established with a single partner or shareholder. JSCs and LLPs can be incorporated with a minimum share capital of TRY50,000 (\$8,600 as of June 14 2019) or TRY10,000 (\$1,725 as of June 14 2019), respectively. For JSCs, one-quarter of the share capital must be paid before registration and the remainder must be paid within 24 months. There is no initial one-quarter payment requirement for LLPs and the entire share capital can be paid within 24 months.

The incorporation or establishment procedures for a JSC and an LLP are very similar and include the following steps:

- Preparation of the company's articles of association;
- Registration of the company with the relevant trade registry office;
- Announcement of incorporation or establishment in the Turkish Trade Registry Gazette.

Once the company's articles of association are signed and notarised and the company has obtained a potential tax number, a bank account needs to be opened to deposit the capital of the company.

All companies must register with the trade registry of the city where the company will have its headquarters by submitting its notarised articles of association along with other requisite documentation.

Dispute resolution

A bilateral investment protection treaty (BIT) was signed between Turkey and China on November 13 1990 and has been in force since August 20 1994 to promote greater economic cooperation. Turkey has executed 105 BITs so far and 80 of them are in effect. More recently, the new Civil Procedure Code (CPC) No. 6100 entered into force in 2011 with the aim of increasing the speed and overall efficiency of procedure.

In order to initiate legal proceedings in Turkey, foreign legal or natural persons have to provide a security at the court's discretion pursuant to Article 48 of the Code on Private International Law and Law of Civil Procedure (Law No. 5718). Turkey and China executed a bilateral treaty named the Agreement on Judicial Assistance in Civil, Commercial and Penal Matters on September 27 1994 and this provides mutual exemption from security payments.

Recently, alternative dispute resolution procedures have gained wider use in Turkey.

There is no blanket tax incentive scheme specific to foreign direct investment

Mediation was held mandatory initially for employment disputes and has recently been adopted for certain commercial disputes concerning receivables and damages claims, making it mandatory for the parties to try to settle through mediation before resorting to court proceedings.

The conditions of enforcement of a foreign judgment in Turkey are governed by Law No. 5718, which provides that the competent Turkish court shall render the enforcement of a foreign judgment without re-examination of the merits if it satisfies the following conditions:

- the judgment must be final and binding without any possible recourse to appeal;
- *de facto* or *de jure* reciprocity must exist between Turkey and the country rendering the judgment;
- the subject matter of the judgment must not fall under the exclusive jurisdiction of Turkish courts such as real estate matters;
- due process must be respected and the right to be heard should be respected;
- the judgment must not be contrary to a pending case with same Parties and same subject matter or to a former foreign judgment that satisfies the same criteria which is enforceable in Turkey; and
- the court decision shall not contradict Turkish public policy.

In terms of enforcing foreign arbitral awards, the New York Convention has precedence and is treated as part of the Turkish domestic legal system. Turkey ratified the Convention with two reservations, which means that the enforcement of foreign awards will be subject to the Convention if the award was rendered in another signatory state and the relevant dispute is defined as commercial under the Turkish Commercial Code. China also ratified the Convention on January 22, 1987.

Turkey has entered into BITs with many countries, including China (September 8 2016) for the reciprocal recognition and enforcement of judgments on civil and commercial matters. Its membership of the New York Convention enables recognition

and enforcement of Turkish decisions or awards in other contracting parties' jurisdictions.

Forex controls and local operations

Article 3 of the Foreign Direct Investment Law No. 4875 assures investors unrestricted repatriation of profits. Foreign investors are free to repatriate net profits, dividends and proceeds from the sale or liquidation of all or any part of an investment; royalties or fees from licence, management and similar agreements; or principal and interest payments of loans.

Decree No. 32 on the Protection of the Value of Turkish Currency (Decree No. 32) restricts Turkish companies that do not have foreign exchange income from borrowing foreign currency loans. Several noteworthy exceptions apply to this restriction in the case of banks or financial institutions or in the financing of public-private partnership (PPP) projects.

Decree No. 32 was recently amended to introduce restrictions against prices in agreements for the lease and sale of real estate, construction, employment, and services from being denominated in foreign currency. However, the restrictions have limited applicability to foreign investors, thanks to the numerous exceptions provided for transactions having a foreign element. For instance, agreements for the sale or lease of real estate is not subject to restrictions on foreign currency indexation, if executed by the Turkish subsidiary of a foreign investor acting either as buyer or tenant.

Tax

European jurisdictions with favourable taxation regimes and wide networks of bilateral treaties, such as the Netherlands or Luxembourg, are sometimes used to host intermediate holding companies in the acquisition of Turkish targets. An important

motivation behind these structures are the tax benefits available under the tax treaties between these respective countries and Turkey, such as the reduction of Turkish withholding tax rates on dividends and interest and the exemption from local capital gains taxes realised on exit from an investment in a Turkish target company.

Turkey's corporate income tax rate of 20% was increased to 22% for the period between 2018-20. The withholding tax on dividends is 15%.

There is no blanket tax incentive scheme specific to foreign direct investment (FDI). However, FDI may benefit from various tax incentives generally available to both foreign and local investors. The following incentives are available within the Turkish Incentive System, subject to certain terms and conditions: VAT exemption; customs duty exemption; tax reduction; social security premium support; interest support; land allocation; VAT refund and income tax withholding support.

Investors should apply for an Investment Incentive Certificate to benefit from one of the incentive schemes that its investment qualifies for; for example, the General Investment Incentives System, Large-Scale Investment Incentives System, Regional Investment Incentives System, Strategic Investment Incentive System or Project-Specific Investment System. These schemes offer varying advantages and are offered based on the regions or sectors that the intended investment relates to. The most beneficial incentives are available for promoting domestic production of goods that mainly rely on imports, thereby reducing the trade deficit. In such cases, incentives also include purchasing guarantees, certain exemptions from regulatory approvals, in addition to classic tax incentives and financing support.

The Agreement between The People's Republic of China and The Republic of Turkey for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income was signed on May 23 1995 between Turkey and China to address double taxation. Accordingly, the withholding tax rate for dividends shall not exceed 10% of gross dividends if the beneficial owner is a resident of the other contracting party. Effective withholding tax charged for interest shall not exceed 10% of the gross amount of interest or royalties.