

SEPTEMBER-OCTOBER 2010 | WWW.WORLDFINANCE.COM

PUBLISHED BY WORLD NEWS MEDIA

WORLD FINANCE

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IMPLICATIONS OF TURKEY'S TAX CODE

Legal issues on mergers in Turkey, from a taxation perspective

■ The merging of Turkish companies is mainly regulated by the Turkish Commercial Code numbered 6762 from June 1956 and the tax free merger is regulated under Article 19 and 20 of the Corporate Tax Law numbered 5520.

As per the Code, a merger is a transaction, where one or more companies (the same type) merge into one of such companies or a new company to be formed, whereby the existence of the merging one ceases. Such procedure is governed under the rules of "termination without liquidation" under the Turkish Commercial Code as the dissolving company does not liquidate, but is taken over by the other as a complete subrogation with all of its assets and liabilities and the company taking over is deemed to be a continuation of the dissolving company.

In general, merger transactions take place at market price and corporate tax would be payable on the excess amount over the book values. However, Corporate Tax Law brought an exception to this "tax-free merger".

Tax-free merger is defined as the transfer of all of the assets and liabilities of a company over their book values as of the date of take-over to another company. The requirements for a tax free merger are that (i) the legal or business centres of the two companies must be in Turkey and (ii) the balance sheet values of the dissolved company on the date of the transfer be acquired by the surviving company as a whole and are incorporated in the balance sheet as is.

In the event of a tax-free merger, only the taxable profit derived by the dissolved company until the merger date will be subject to corporate tax and no taxation will arise due to the merger transaction. Tax-free merger transactions are also exempted from VAT, stamp tax and any other fees.

EFFECTIVENESS OF A MERGER

According to Article 150/1 of the Turkish Commercial Code, the final resolution of the shareholders of the two companies to be merged regarding the merger shall become effective "only after three months as of the date of the announcement of such resolution in the Commercial Registry Gazette". The purpose

of the provision is to protect the creditors of the two companies. Nevertheless, before such announcement; (i) if the merging companies have paid their debts or (ii) deposited the amount of cash corresponding to their debts in the Central Bank of Republic of Turkey or to any other standing bank or (iii) the creditors have approved the merger of the companies, then the resolution regarding the merger shall be effective as of the date of the announcement in the Commercial Registry Gazette.

While the Turkish Commercial Code, being the main legislation governing the

IN GENERAL, MERGER TRANSACTIONS TAKE PLACE AT MARKET PRICE

commercial companies, rules as said above, according to the Article 20/1(a) of the Corporate Tax Law, providing tax exemption on mergers, the date of the transfer of the dissolved company into the merged company is "the date of the registration of the resolution" taken by the shareholders of the companies regarding the transfer (ie merger) with the Commercial Registry.

Thus, regarding the effective date of the merger of two companies, there is a confusion between the Turkish Commercial Code and the Corporate Tax Law. The confusion is that in order to be able to benefit from the tax exemption, the companies should follow Article 20/1(a) of the Corporate Tax Law stating that the merger shall be valid as of the "registration date of the merger decision" with the Commercial Registry. Thus, the practical outcome would be that such dissolving company would stop operating i.e. cease of sales, cease of issuance of invoices etc, as of "the registration date of the merger decision with the Commercial Registry". Whereas at such time:

i) The merger would not have been announced in the Commercial Registry Gazette to third parties and

ii) The dissolving company would not have been de-registered with the Commercial Registry, and the merger would not have been finalised under the Turkish Commercial Code.

NATURE OF THE CAPITAL INCREASE IN A MERGER

During the merger process of two companies, in line with the Turkish Commercial Court requirements a sworn auditor report or a financial expert report is issued to determine the equity of the two companies at a specific time to be decided by the shareholders of such two companies for the purposes of calculation of the share capital increase in the surviving company.

Whereas, as stated above, Corporate Tax Law rules that if the balance sheet values of the dissolved company on the date of the transfer is acquired by the surviving company as a whole and is incorporated in the balance sheet as is, then such shall be considered as a tax free merger.

Additionally, according to Corporate Tax Law, tax losses of legal entities can be carried forward to be used against profits in future for five years. In case of a tax free merger, the losses of the dissolved company is also transferred to the surviving company and such losses, which do not exceed the amount of the equity of the dissolving company as of the merger date, may be carried forward to be used for five years against the surviving company's future profit provided that below stated conditions are met:

i) Corporate tax returns of the last five years should have been filed within the legal period.

ii) The activity of the dissolving company should be carried on for five years as of the fiscal period in which the merger is realised.

Therefore, the financial consultants in the market interpret such provisions as follows:

In order to benefit from the exemption in the Corporate Tax Law, regardless of whether the determined equity of the dissolving company in such reports is lower or higher than or equal to such dissolving company's share capital in its articles of association, the dissolving company's share capital should be considered as the amount to be contributed to the capital increase of the surviving company.

Consequently, if the determined equity of the dissolving company is considered for the capital increase in the surviving company, then the merging companies may not benefit from the tax free merger stipulated under Article 19 and 20 of the Corporate Tax Law. ◇

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