CIRCULAR **Istanbul, October 5, 2018**
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Subject:
THE COMMUNIQUÉ IS PUBLISHED ON THE PROCEDURES AND PRINCIPLES TO BE OBSERVED BY THE MANAGEMENT BODY AND GENERAL ASSEMBLY IN CALCULATIONS REGARDING THE CASE OF LOSS OF CAPITAL OR BEING ENCUMBERED WITH DEBT IN EQUITY COMPANIES

The procedures and principles in case of capital loss or being encumbered with debt for **joint-stock** and **limited companies** and **limited partnerships divided into shares** have been defined within the scope of Article 376 of the Turkish Commercial Code (TCC) by "the Communiqué on the Procedures and Principles Regarding the Execution of Article 376 of the Turkish Commercial Code No. 6102" published in the Official Gazette No. 30535 of September 14, 2018.

Article 376 of the Turkish Commercial Code is as follows:

" ***Capital loss, being encumbered with debt***

Liability to convoke and notify

ARTICLE 376 - (1) If it is clear in the last annual balance sheet that half of the sum of the capital and contingency reserves is unsecured due to loss, the Board of Directors shall immediately convoke the General Assembly and submit the remedial measures it deems appropriate.

(2) According to the last annual balance sheet, if it is clear that two-thirds of the sum of the capital and contingency reserves are unsecured due to loss, unless the General Assembly immediately convoked decides to fully supplement the capital or to be satisfied with one-third of the capital, the company shall automatically terminate.

(3) If suspicions are raised that the company is encumbered with debt, the Board of Directors shall have an interim balance sheet prepared based on the going concern value and based on liquidation value of the assets. If it is clear in the report that the assets are not sufficient to cover the receivables of creditors of the company, the Board of Directors shall notify the commercial court of first instance at the location of the company's headquarters of this situation and shall file a claim for bankruptcy. This shall be done provided that before the adjudication of bankruptcy, the company's creditors representing an amount sufficient to cover the company's deficit and to eliminate the indebtness of the company accept in writing that they will be ranked after all other creditors and that the legitimacy, authenticity and validity of this agreement is verified by experts assigned by the court which shall be notified of the request for bankruptcy by the Board of Directors. Otherwise the application made to the court for an expert inspection shall be considered as notification of bankruptcy."

The amendments in the Communiqué regarding the implementation rules and procedures of the above Article are briefly summarized below.

1. CAPITAL LOSS
(*Actions to Be Taken If At Least Half or Two-Thirds of The Sum of The Capital and Contingency Reserves are Unsecured Due to Loss*)

1.1. CONVOCATION OF GENERAL ASSEMBLY

According to the **last annual balance sheet**, if it is clear that **at least half or two-thirds** of the sum of the capital and contingency reserves are unsecured due to loss, **the management body** will **immediately convoke the General Assembly.**

The sum of the capital and contingency reserves being unsecured will be stated in the agenda items of the General Assembly.

In case of at least half or two-thirds of the sum of the capital and contingency reserves being unsecured due to loss, this matter will be discussed at the General Assembly even if it was convoked for a different agenda.

1.2. GENERAL ASSEMBLY IN CASE OF AT LEAST HALF OF THE SUM OF THE CAPITAL AND CONTINGENCY RESERVES BEING UNSECURED

In case of at least half of the sum of the capital and contingency reserves being unsecured, **the management body will submit remedial measures it considers appropriate to the General Assembly.**

The management body will clarify the financial circumstance of the company to in a manner that can be understood by all of the partners by submitting the last balance sheet to the General Assembly. It may also submit a report to the General Assembly.

In order to stop or lessen the effects of the deterioration of the company's financial status, the management body may submit and explain remedial measures **such as**:

- ✓ Completing the capital,
- ✓ Increasing the capital,
- ✓ Downsizing or shutting down certain production units or departments,
- ✓ Liquidation of affiliates,
- ✓ Changing the marketing system

that it deems appropriate**, providing alternatives in a comparative manner** to the same General Assembly.

The General Assembly may accept the remedial measures as they are, or it may accept them after modifying them, or resolve to implement a different measure than those already submitted.

1.3. GENERAL ASSEMBLY IN CASE OF AT LEAST TWO-THIRDS OF THE SUM OF THE CAPITAL AND CONTINGENCY RESERVES BEING UNSECURED DUE TO LOSS

In case of at least two-thirds of the sum of the capital and contingency reserves being unsecured due to loss, the General Assembly to be convoked may resolve to:

a) Settle for one-third of the capital and decrease the capital in accordance with Articles 473 and 475 of the Turkish Commercial Code,

b) Complete the capital,

c) Increase the capital.

In case of at least two-thirds of the sum of the capital and contingency reserves being unsecured due to loss, if the General Assembly **does not resolve to implement one of the measures listed above**, **THE COMPANY WILL AUTOMATICALLY TERMINATE**. The liquidation procedures of companies that are terminated in this manner will be carried out in accordance with Article 536 of TTC and the subsequent articles.

1.3.1. CAPITAL REDUCTION

If the General Assembly of the company resolves to settle for one-third of the capital in the case of at least two-thirds of the sum of the capital and contingency reserves being unsecured due to loss, the capital will be reduced.

In case of the capital reduction executed within the scope of this Article, the management body may resolve to not summoning the creditors and forfeiting the payment or securing of their receivables.

1.3.2. CAPITAL REPLENISHMENT

Capital replenishment is the covering of balance sheet deficits by all or some of the partners.

There is no requirement to cover the deficits of the contingency reserves.

If it is resolved to replenish the capital, each partner is obligated to pay the amount that covers the unsecured amount suffered due to loss.

Each partner will contribute in proportion with their share, however they will not receive their money back. Participating in capital replenishment is not considered as an investment or loan, it is non-refundable.

Moreover**, the payments effected <u>will not be regarded as advances for future capital increases</u>**.

The capital replenishment will be executed in accordance with Article 421 (2)(a) regarding joint-stock companies and limited partnerships divided into shares, and Article 603 and subsequent articles will be enforced for limited companies.

"421/2- The resolutions regarding the Articles of Association are made with the unanimous participation of all shareholders of the capital or their representatives.
a) Resolutions that impose liabilities or secondary liabilities to cover the financial sheet losses"

Not being able to replenish the capital will not prevent certain partners from replenishing on their own will.

<u>The payments effected as per the liabilities imposed to cover the financial sheet losses will be collected in a CAPITAL REPLENISHMENT FUND ACCOUNT within equities and they will be tracked.</u>

With this regulation, ***"Capital replenishment fund"*** is mentioned for the first time in our legislation.

As mentioned above, **this fund** will not be regarded as **advances for future capital increases**. Moreover, the partners will not be able to demand a refund since the fund in question is not a loan.

According to the Communiqué letter, the fund is not regarded as capital, and setting it aside as capital commitments payables is not allowed. Therefore, we believe that the issue of whether this fund in equities will be added to the capital or not in the future should be clarified.

In certain past rulings issued by the Ministry of Treasury and Finance, there are some comments stating that the capital replenishment funds provided by the partners to compensate the losses should be considered as income. We would like to remark that there is a necessity for a regulation to be made by the Ministry of Treasury and Finance as well, in parallel with those made by the Ministry of Commerce stating that the capital replenishment fund payments are not subjected to corporate tax.

Article 6/4 of the Circular on Capital Movements issued by the Central Bank of the Republic of Turkey on May 2, 2018 states that "*The addition and documenting* of the ***foreign currency inflow*** carried out via *banks* that are declared to be for the ***<u>purpose of capital increase</u>*** have to be finalized ***within three months at the latest.***" *<u>Failure to add this foreign currency to the capital and document the capital increase will result in the foreign currency inflow</u>* being regarded as a ***<u>credit transaction</u>*** as per the foreign exchange legislation". According to this, will the payments to be effected by the partners of especially foreign-capital companies under the name of "capital replenishment fund" be considered as capital or credit according to the foreign exchange legislation? This issue also has to be clarified in terms of foreign exchange legislation.

We would like to remark that being direct or indirect parties of the regulation made via the Communiqué on Article 376 of TCC, the Ministry of Commerce, the Ministry of Treasury and Finance and the Central Bank of the Republic of Turkey have to make the necessary regulations for the implementation to be executed seamlessly and eliminating the points of hesitation.

1.3.3. CAPITAL INCREASE

General Assembly may:

a) resolve to increasing the capital simultaneously with reducing the capital as much as the losses suffered. At least one-fourth of the increased capital must be paid in the simultaneous processes of capital reduction and capital increase.

b) resolve to increasing the capital without reducing the capital as much as the losses suffered. In capital increases to be executed in this manner, **the amount to cover at least half of the capital** will be have to be paid before registration.

2. THE SUM OF THE CAPITAL AND CONTINGENCY RESERVES BEING COMPLETELY UNSECURED

BEING ENCUMBERED WITH DEBT

Being encumbered with debt is defined in the Communiqué as the assets of the company not covering the liabilities. The signals being encumbered with debt can be detected in annual and interim balance sheets, the audit reports in audited companies, the reports of early detection committee and the assessment of the management body.

If suspicions are raised that the company's liabilities exceed its assets, the management body shall have an interim balance sheet prepared based on the going concern value and based on liquidation value of the assets. The management body shall apply to the court for the bankruptcy of the company if it resolves that the assets do not cover the liabilities as per the interim balance sheet prepared based on the going concern value and based on liquidation value of the assets and does not take the measures specified in Article 7 of the Communiqué (either one of the measures capital increase or capital replenishment).

3. BALANCE SHEETS TO BE THE BASIS

The balance sheets to be prepared in accordance with Article 88 of TCC shall serve as basis in determining circumstances of capital loss or excess liabilities over assets. It is known that as per Article 88 of TCC, the authority to determine which businesses shall carry out financial reporting in accordance with the Turkish Accounting Standards (TAS) is delegated to the Public Oversight, Accounting and Auditing Standards Authority (POAASA). Companies that are obligated by POAASA to comply with TAS will determine their capital adequacy (loss of capital or being encumbered with debt) based on these balance sheets within the scope of Article 376 of the Code. Companies that are not required to comply with TAS will base their determination on the balance sheets that they prepare in accordance with the provisions of Tax Procedure Law (TPL).

If TAS is preferred voluntarily for preparing the balance sheets, then the balance sheets prepared in accordance with TAS will serve as basis for determining circumstances of capital loss or being encumbered with debt.

4. PARTICIPATING IN MERGERS IN CASES OF CAPITAL LOSS OR BEING ENCUMBERED IN DEBT

A company that suffers capital loss or is encumbered with debt can merge with a company that has enough net assets that can cover the capital loss.

If a company that participates in a merger has suffered loss of capital and contingency reserves, or they are encumbered with debt, the other party having enough net assets to cover the capital loss or indebtness of the other company and the relevant fees will be confirmed by the account form or that the circumstances mentioned not existing will be proven by the report written by a sworn-in certified public accountant or certified public accountant financial advisor. If the transferred companies are audited, this report may be prepared by the auditor of the audited company.

5. REDUCING FOREIGN EXCHANGE DIFFERENCE LOSSES FROM TRADING LOSS IN CALCULATIONS MADE REGARDING CAPITAL LOSS OR BEING ENCUMBERED WITH DEBT

According to Provisional Article 1 of the Communiqué, in calculations concerning capital loss or being encumbered with debt, **the foreign exchange difference losses that are due to non-performed foreign currency liabilities** may not be taken into consideration **until January 1, 2023**. The implementation is not obligatory; it is up to the companies to decide. We can say that this regulation aims to compensate the damages suffered by the financial sheets of companies due to the unusual spike in exchange rates lately.

Sincerely,

DENGE İSTANBUL YEMİNLİ MALİ MÜŞAVİRLİK A.Ş.

ANNEX:
Communiqué on the Procedures and Principles Regarding the Execution of Article 376 of the Turkish Commercial Code No. 6102

(*) The descriptions included in our circulars are for information purposes only. We recommend you to consult an expert before making any final transactions in any matter when you have any hesitations; and our office will not have any liability for any loss arising from transactions that are made relying solely on statements in our circulars.

(**) Please contact our experts for your opinions, comments, and questions about our circulars.

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