



## **Pros and Cons: Liquidation or Demerger**

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### **(1) Introduction**

Liquidation and demerger (*spin-off*) are regulated under the Turkish Commercial Code (“TCC”).

In case of existence of liquidation grounds, a company may enter into liquidation and terminate its legal personality, or it may terminate its legal personality by transferring its assets through full demerger. Both concepts relatively represent termination of a business under a legal personality. That said, while liquidation refers to final dissolution of a business, demerger is indeed a new beginning under another legal personality.

Accordingly, this article aims to provide a comparative overview on the impact of the dissolution of a company through liquidation or demerger on shareholders, assets, and creditors from the Turkish law perspective.

### **(2) Characteristics of Liquidation**

As per the TCC, companies gain legal personality upon registration in the trade registry and their legal personalities cease upon de-registration from the trade registry upon occurrence of the events stipulated in the law. Provisions in the TCC regarding liquidation of joint stock companies, also apply for limited liability companies. Accordingly, our explanations in this section apply both.

We will first evaluate why companies are liquidated or obliged to enter into liquidation. Article 529 and following articles of the TCC regulate termination of a joint stock company. The reasons for termination of a company are as follows; (i) the expiration of the term stipulated in the articles of association; (ii) realization or impossibility of realization of the subject of the company’s business; (iii) realization of one of the reasons for termination, if stated in the articles of association; (iv) termination of the company through the decision of the general assembly; (v) decision to declare the company bankrupt and (vi) realization of other situations stipulated in the TCC. As a rule, a company that is terminated for one of the foregoing reasons enters into the liquidation process and the company would be dissolved and de-registered from the trade registry upon completion of the liquidation steps.

When the company enters into liquidation the main consequences can be listed as follows:

- (i) it preserves its legal personality until the end of the liquidation process,
- (ii) the company must and focus only on actions and transactions necessary for finalization of the liquidation,
- (iii) as a general rule, a liquidation officer is appointed to lead and manage the liquidation process,
- (iv) duties and powers of the general assembly and the board of directors are reserved for transactions that cannot be performed by the liquidation officer,
- (v) commercial title of the company changes and a phrase “in liquidation” shall be added to the trade name of the company and this title shall be registered with the trade registry.

Liquidation officer is expected to fulfill mainly the following duties:

- (i) examine financial status of the company, and, if necessary, apply to experts to determine valuation of the company's assets,
- (ii) prepare an inventory and liquidation balance sheet demonstrating the situation regarding the company's assets and financial situation,
- (iii) pay debts, collect receivables and dispose all assets of the company,
- (iv) repay share values of the shareholders to the shareholders,
- (v) if any, remaining assets will be distributed to the shareholders,
- (vi) final balance sheet will be prepared as showing “zero” balance.

As to the liquidation procedure, legislator has attached particular importance to the protection of the creditors. The creditors shall be notified of the liquidation process through registered letter or announcements to be made in the trade registry gazette according to the requirements of the case at hand, and they shall be called to notify their receivables to the liquidation officer. Upon this call, the creditors will notify the liquidation officer regarding their receivables. Lack of notification does not terminate the receivables and even if the known creditors do not notify their receivables, the amount thereof shall be deposited in the bank to be determined by the Ministry of Trade. TCC also does not require the receivables to be due, and even regulates that the money in the amount of the company's debts that are not due or subject to dispute shall be deposited with the notary public as a rule. However, if debts are sufficiently secured or if the distribution of the company's assets between the shareholders is dependent on the payment of the debts, said amount of the debts does not need to be deposited with a notary public.

As a final step, upon approval of the final balance sheet by the general assembly of shareholders, company will have finalization of the liquidation process registered with trade registry. Upon registration of the liquidation with the trade registry, legal personality of the company will end.

### **(3) Characteristics of Demerger**

TCC regulates the demerger in two categories: full demerger and partial demerger. The most important characteristic that distinguishes a full demerger from a partial demerger is that the company that is fully demerged would terminate and de-registered from the trade registry. In a partial demerger, on the other hand, the company maintains its registration with trade registry and only one or more parts of its assets are transferred to another company. In this section, full demerger will be evaluated, and explanations will be made regarding the full demerger process and its consequences, which result in the end of the legal personality of the company. Accordingly, the term “demerger” in this section refers to a “full demerger”.

According to the TCC, entire assets of a company that is fully demerged are divided into parts and transferred to more than one company. Acquiring companies may be newly incorporated companies or already existing companies. Shareholders of the demerged company acquire shares and rights of the acquiring companies in exchange for the assets of the demerged company. During the acquisition of the shares, the share ratios of the shareholders of the demerged company may be preserved or these ratios may not be preserved. At this point, TCC has divided full demerger transactions into two categories: those in which the ratios are preserved and those in which the ratios are not preserved and allow the acquisition of shares through both ways according to the needs of the case at hand.

A company which decides to initiate a demerger process must prepare an interim balance sheet. Then, a demerger agreement or a demerger plan is prepared in the case of a demerger through a new incorporation. The demerger agreement/plan must contain the contents listed in the TCC. These points

are not limited and can be expanded. The demerger agreement/plan also explains in detail how the assets will be divided as well as what will be the status of the assets not allocated in the demerger agreement. Article 168 of TCC has answered this question and accordingly, in a full demerger, all transferee companies are entitled to share ownership according to the proportion of the net active assets transferred to them as per the demerger agreement or plan. This provision shall apply by analogy for receivables and intangible assets as well. All the companies participating in the full demerger will be jointly and severally liable for the outstanding debts that have not been allocated. Following the demerger plan or agreement, the demerger report is prepared by the board of directors. This report aims to explain the effects of the demerger on the company. Content of the report is set forth in the TCC and is largely parallel to the content of the demerger agreement. That said, the demerger report aims to explain the legal effects of the demerger agreement.

In this regard, although a general framework is drawn up regarding the stages of demerger by the TCC, board of directors of the company conducts the demerger.

TCC also provides provisions around protection of creditors in a demerger process. Accordingly, in a demerger, the creditors are called and requested to declare their receivables and to request guarantees. That being the rule, companies may be released from the obligation to provide guarantees by proving that the receivables are not endangered or by paying the debt in full.

Upon protection or payment of the creditors, demerger process may be finalized through approval of the demerger agreement or plan by the general assembly. Following the approval of the demerger decision, it shall be registered with the trade registry and upon registration of the demerger; transferring company is de-registered from the trade registry. With the registration, assets of the transferred company are transferred to the transferee companies, and the company does not enter a process such as liquidation. As a matter of fact, Article 19 of the Corporate Tax Law clearly regulates that a full demerger will result in the dissolution of the company without liquidation. Thus, the company loses its legal personality, and its legal existence ends without going through the liquidation process.

#### **(4) Main Similarities and Differences**

Liquidation is the de-registration of the company from the trade registry upon the realization of one of the reasons for the liquidation of the company set forth in the TCC, by performing various transactions on the assets of the company until the company is de-registered from the trade registry. On the other hand, in a demerger, there is no liquidation process and with the registration of the demerger decision, assets of the company that are demerged are acquired by the transferee company and the company is de-registered from the trade registry.

In both liquidation and demerger processes, creditors are protected through an announcement on initiation of the respective process and invitation to notify their receivables.

Another difference is that, liquidation officer leads the liquidation process and manages the company during the liquidation process; however, no special officer or body dedicated to the demerger is foreseen in the TCC during the demerger process and during the realization of the transactions in preparation for the demerger. Board of directors of the company carries out the demerger procedures.

In terms of the effects of a demerger and liquidation on shareholders, TCC aims to protect the shareholders in both cases. This protection appears in different ways, as a result of liquidation, shareholders receive the assets remaining from the liquidation in their proportion and do not acquire

any shares. In a full demerger, shareholders of the demerged company acquire shares from the companies to which the assets are transferred and indirectly hold their shares in the demerger where the ratios are preserved.

Ultimately, the most significant similarity between liquidation and full demerger is the termination of the legal personality of the company as a result. In liquidation, the termination of this legal personality occurs with de-registration of the company from the trade registry upon the end of the liquidation, while in full demerger, it occurs with the registration of the demerger decision to the trade registry.

### **(5) Conclusion**

All in all, although the TCC regulates liquidation and demerger separately, the main result of liquidation and demerger is de-registration of the company from the trade registry. Although the legal personality of the company is ended in both ways, the effects and consequences of the termination may be different. Therefore, if a company seeks to be de-registered, it is important to evaluate both options from legal, tax and financial perspectives to decide on the most advantageous process.

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