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CAPITAL REDUCTION IN TURKISH COMPANIES: THE EXCEPTION TO CREDITOR NOTIFICATION WHEN COVERING ACCUMULATED LOSSES

Introduction

Capital reduction is a significant corporate mechanism under Turkish law, employed by companies to realign their financial structure. Among its strategic uses, reducing capital to offset accumulated past losses allows businesses to strengthen their balance sheets, improve solvency, and potentially create more flexibility for future investment or restructuring efforts. This article explores the legal framework and procedural steps for capital reductions in Turkish companies, focusing particularly on the process where the reduction is made solely to cover accumulated losses, thus eliminating the need for creditor notifications.

Legal Framework for Capital Reduction

The legal framework for capital reduction in Turkish companies is primarily governed by the Turkish Commercial Code (TCC), with key procedural guidelines set out in the Trade Registry Regulation. These regulations are designed to protect the interests of creditors while allowing companies the flexibility to adjust their capital structures. Capital reductions must adhere to specific documentation and procedural requirements, including the preparation of a comprehensive report by the company's Board of Managers (BoM) and another by a certified public accountant (CPA), which justifies the reduction and ensures compliance with general principles of creditor protection, unless specific exceptions apply.

Exception for Notification to Creditors

In standard capital reduction procedures, companies must notify creditors and allow them a two-month window to claim payments or request security. However, an important exception exists when the reduction is made solely to offset past losses. This exception aims to streamline the capital reduction process, acknowledging that creditors' rights are not at risk when the reduction directly addresses accumulated losses rather than impacting their ability to recover owed funds. Thus, when the capital reduction solely serves to cover deficits from prior years, creditor notification can be bypassed, significantly expediting the process.

It is also possible to make a capital reduction by making a declaration to the creditors and offsetting the previous years' losses, irrespective of whether the company's equity is positive or negative. This allows companies to proceed with the reduction even when their overall equity position may not be favorable, as long as the reduction serves the purpose of addressing accumulated losses.

The legal basis for this exception is established under **Turkish Commercial Code Article 474**, which states:

> **Article 474**
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> (1) If the general assembly decides to reduce the share capital, the Board of Directors must announce the decision on the company's website, as well as in a newspaper in accordance with Article 35 and in the manner stipulated in the articles of association. This announcement must be made three times at seven-day intervals. The announcement must inform creditors that they have two months from the third announcement in the Turkish Trade Registry Gazette to notify the company of their receivables and request payment or security for those receivables. Known creditors must also receive personal notices.
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> (2) If the share capital is to be reduced to cover deficits created by losses reflected in the balance sheet, the Board of Directors may waive the requirement to notify creditors and to provide payment or security for their claims.

Steps for Implementing a Capital Reduction

1. **Preparation of Key Documentation:**
   - **Board of Managers Report:** A detailed report justifying the reduction, prepared in compliance with Article 96 of the Trade Registry Regulation.
   - **Board Decision to Convene a Shareholders Meeting:** This includes the decision to proceed with the capital reduction and, if applicable, the decision to forgo creditor notification.
   - **Shareholders Meeting Minutes:** Resolutions approving the capital reduction, amending the Articles of Association, and adopting the BoM report.
   - **Amendment Text for Articles of Association:** The required updates to reflect the reduced capital.
   - **Power of Attorney:** Authorization for legal representatives to complete the necessary registration procedures.

2. **Engagement of a Certified Public Accountant:**

    - CPA must provide a report confirming the company's financial status, verifying that the capital reduction is justifiable and ensuring compliance with regulatory requirements. Specifically, the CPA must state that the company will have sufficient assets to fully cover the rights of the company's creditors after the reduction. This report is essential for validating that the company's financial position supports the reduction and that it will not adversely affect creditors.

3. **Registry Submission and Approval:**

    - After preparing all necessary documentation, it must be submitted to the relevant trade registry for review and approval. The trade registry will examine the documentation to ensure that all legal requirements have been met, including proper notification (where applicable) and alignment with the company's financial standing. The company's General Assembly resolution approving the capital reduction and any associated amendments to the Articles of Association will also be considered.

Practical Considerations

Implementing a capital reduction requires careful planning and strict adherence to legal procedures.

Companies should:

- ensure all documentation is comprehensive, accurate, and in full compliance with the Turkish Commercial Code and related regulations.

- work closely with legal counsel and certified public accountants to mitigate any potential legal or financial risks, particularly the possibility of disputes from creditors or shareholders.

- be mindful of local trade registry practices, which can differ between jurisdictions, and account for any specific requirements in the company's region.

Conclusion

Capital reduction is a powerful tool for Turkish companies, particularly when used to offset accumulated losses. By strategically reducing capital, companies can improve their financial stability, enhance their capacity for future growth, and better position themselves in a competitive market. Utilizing the exception to creditor notification requirements, when the reduction is solely for covering losses, can significantly streamline the process, ensuring efficiency and compliance. Moreover, the ability to reduce capital to cover previous years' losses, regardless of whether equity is positive, provides further flexibility. As with any significant corporate action, professional guidance and meticulous preparation are essential to ensure the success of a capital reduction and its long-term benefits for the company.

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