

Loss of Capital in Türkiye

Introduction

Under Turkish Commercial Code ("TCC"), companies are obliged to prepare financial statements annually. These financial statements are prepared by the Board of Directors ("BoD") for the previous accounting period within the first quarter of the fiscal year and submitted to the General Assembly ("GA"). Financial statements, such as income statements or balance sheets, are basically informative statements that reveal the financial structure of a company and have to be prepared in a transparent manner. These statements, which encompass various financial details and performance indicators, play a crucial role in monitoring the company's financial health. The loss of capital indicates the deterioration at the financial health of the company. Loss of capital, which is regulated under TCC, will be briefly explained in this article.

Loss of Equity Against Losses

Under the principle of "accounting (or balance sheet) equation", the assets of a company are equal to the sum of its liabilities and shareholders' equity. In a balance sheet, equity is an item under liabilities. However, it is not a financial liability; instead, it is a legal liability. Equity consists of the capital, statutory and non-statutory reserves, profit, loss and re-evaluation funds. Equity can decrease for reasons such as capital reduction, dividend payments, and losses.

Loss of capital is regulated under Article 376 of TCC and the relevant Communiqué on Article 376 of TCC. The legislator, by implementing

this article, aims to prevent insolvency, the ways of which are explained in detail in the Communiqué. This provision regulates the measures to be taken when half and two-thirds of the company's total capital and legal reserves are uncovered by losses, or the company is in technical insolvency.

Measures to be taken by the General Assembly

If half of the total of the capital and the statutory reserves are not covered, the BoD is obliged to convene a GA meeting and present remedial measures to the GA. The Board has no restriction in taking remedial measures. These measures may include a capital increase, a capital replenishment, as well as some cost-cutting measures or other measures to reduce the loss.

If the loss is equal to or greater than two-thirds of the sum of the capital and the statutory reserves, the GA may adopt one of the following three measures;

2

► **Capital reduction:** The capital may be reduced to the minimum legal amount to wipe out the accumulated losses provided that at least half of the sum of the capital and the legal reserves remain in the shareholders' equity.

► **Completion of capital:** If it is unanimously decided to replenish the capital, each shareholder must contribute to cover the capital diminished as a result of the losses. Each shareholder's contribution should be proportionate to his/her shareholding and the shareholders are not allowed to withdraw their contribution.

► **Increase of capital:**

a) Capital can be simultaneously reduced and increased by the amount of the loss.

b) Capital can be increased without reducing it by the diminished amount, but an obligatory payment is needed before registration of capital increase to keep at least half the capital and legal reserves in the shareholders' equity.

c) During the same GA meeting, capital can be increased to the desired amount and then reduced by full payment, without the requirement mentioned in the above paragraph b. However, at least half of the total capital and statutory reserves must stay in the shareholders' equity.

Technical Insolvency Situation

Technical insolvency has been regulated in Article 376/3 of TCC. Technical insolvency is a situation in which the company is insolvent, i.e. its total capital and statutory reserves are not sufficient to cover its debts. If there is no concrete reason to assess that the financial situation can be recovered under the interim balance sheet, the BoD of the company must apply to the relevant court for the insolvency of the company.

Conclusion

The protection of financial stability of the companies is significant and the legislator aims to ensure it by providing certain measures. In case of loss of capital, the measures regulated in the law have to be taken by the GA. However, the companies under a technical insolvency have to file for insolvency before the relevant court.

GURULKAN ÇAKIR GÜNAY AVUKATLIK ORTAKLIĞI

Beybi Giz Plaza, Office 43
Maslak 34398
Istanbul, Türkiye

T +90 212 215 30 00
M info@gurulkan.com
W www.gurulkan.com



Gurulkan Çakır Günay Avukatlık Ortaklığı ("Gurulkan Çakır Günay") is an attorney partnership registered at Istanbul Bar Association with a license number 105 and at the Union of Turkish Bar Associations with a license number 206.

This publication provides general information only and should not be relied upon in making any decision. It is not intended to provide legal or other advice. Gurulkan Çakır Günay and its partners will not be liable for any loss or damage arising from reliance being placed on any of the information contained in this publication.

Before acting on any information, readers should consider the appropriateness of the information provided herein, having regard to their legal and financial status, objectives and needs. In particular, readers should seek independent professional advice prior to making any decision.

This publication may not be reproduced, in part or whole, by any process without prior written consent of Gurulkan Çakır Günay.