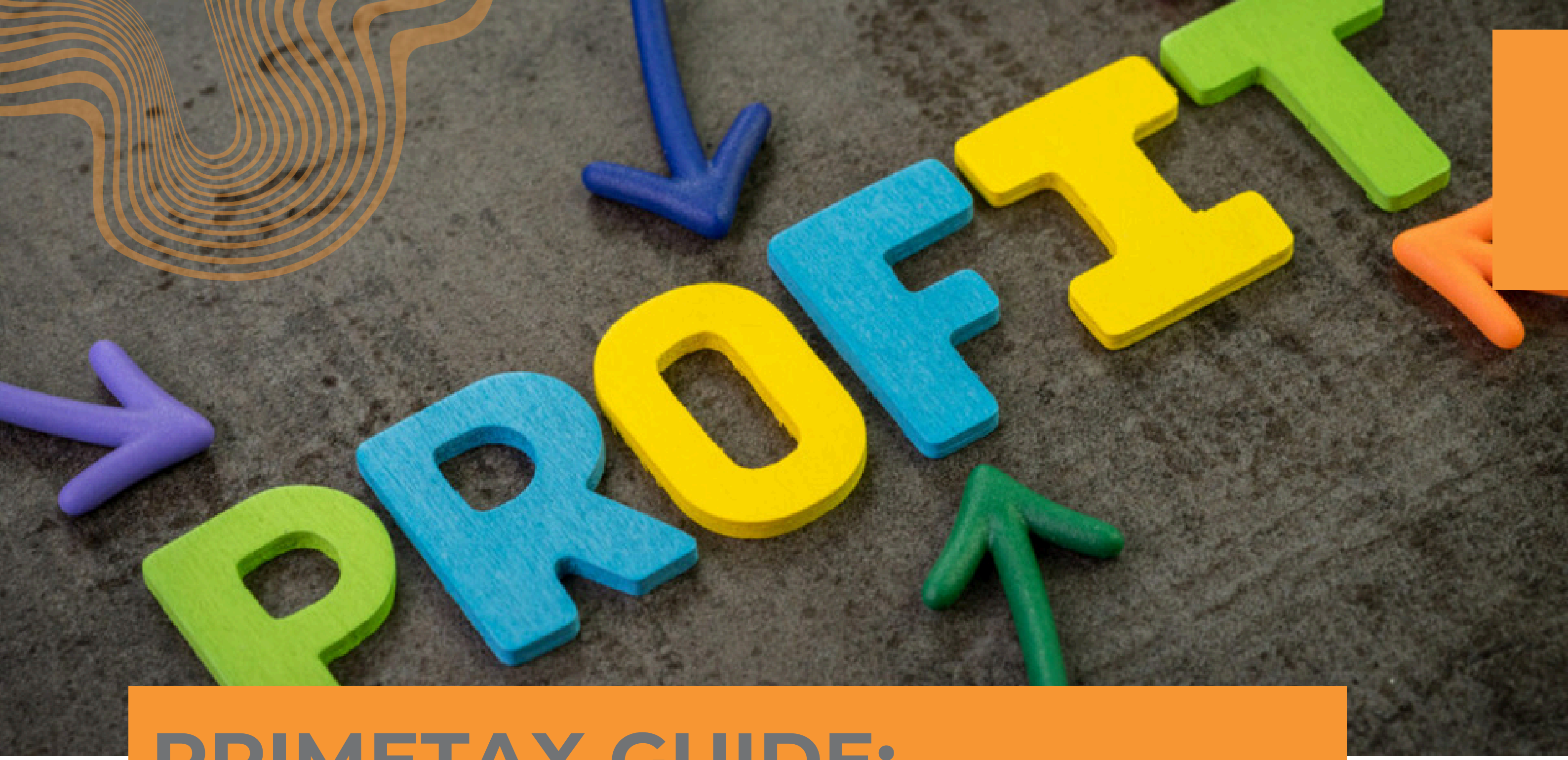

PRIMETAX GUIDE:

PROFIT DISTRIBUTION IN TÜRKİYE

A company aims to generate profit and distribute it to its partners. Due to this characteristic, a shareholder’s right to dividends is a non-renounceable right that cannot be eliminated by any decision and cannot be waived, even with the shareholder’s consent.

Profit repatriation is generally unrestricted unless the company is under the oversight of a higher supervisory authority, such as the Capital Markets Board or the Banking Regulation and Supervision Agency, which requires approval.

Foreign investors can transfer dividends abroad under the Foreign Direct Investment (FDI) Law. However, compliance with the legal reserve requirements outlined in the Turkish Commercial Code is mandatory. While the FDI Law imposes no restrictions on dividend payments, dividend withholding tax must be settled before repatriation. Banks facilitate the transfer and verify that this step has been completed.

Annual accounts are required to support dividend payments; interim accounts may be necessary for advance dividend distributions.

If the company is subject to independent auditing under the Turkish Commercial Code, all accounts, including interim accounts prepared for dividend distribution (e.g., an advance dividend), must also be audited.

According to the Turkish Commercial Code, Turkish companies must allocate first- and second-level legal reserves from their profits:

- First-level legal reserves: Joint-stock and limited liability companies must allocate 5% of their net profits annually to the first-level legal reserve, which is capped at 20% of the paid-in capital. Once this threshold is reached, the obligation to allocate further reserves ceases.

- Second-level legal reserves: These amount to 10% of the profits distributed after deducting the first-level legal reserves and the mandatory minimum dividend (5% of paid-in capital). Second-level legal reserves represent approximately 1/11th of the distributable profit. There is no cap, and they accumulate annually.

Reserve funds represent the residual portion of net annual profits that is not distributed. Their function is to protect against future losses and financial difficulties arising from unexpected expenses and stabilise dividend payments when profits fluctuate.

Legal reserve funds may only be used for the purposes described in Article 519/3 of the Turkish Commercial Code until they exceed half of the share capital or paid-in capital. In other words, once the legal reserves exceed half the share capital, the excess portion may be used freely. These excess funds act as free reserves and may be used for capital increases or dividend payments.

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Dividends may only be distributed from net profits and legal reserves. Before distribution, the Commercial Code requires that 5% of profits (before taxes and prior years' losses) be allocated to statutory legal reserves. This allocation is unnecessary if accumulated reserves exceed 20% of paid-in capital. Voluntary contributions to reserves are also permitted. A dividend of 5% of the company's paid-in capital may be distributed from net profits, with a higher percentage permitted if stipulated in the articles of association.

Advance dividend distributions are permissible if the company has generated profits and the general assembly has resolved to do so in advance. For public companies, such distributions must be explicitly authorised in the articles of association, highlighting the general assembly's crucial role in the decision.

Limited liability and joint-stock companies established under the Turkish Commercial Code may distribute profits reported in interim or quarterly financial statements.

To distribute advance profits during the year, companies must report profits for the first, second, and third advance tax periods and obtain approval through a general assembly resolution. The amount of any advance dividend must not exceed half of the net profit shown in the interim financial statements, after deducting prior years' losses and legal reserves, per the relevant Communiqué.

Additionally, the total advance dividends distributed within one accounting period cannot exceed the lesser of (i) half the net profit for the same period in the previous year or (ii) other sources available for profit distribution, apart from current period profits, as reflected in the relevant interim financial statements.

If more than one advance dividend payment is made within a financial year, the amount paid in each subsequent period must be calculated by deducting the advance dividends already distributed.

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Furthermore, if advance dividend payments were made in previous financial periods, further advances or final dividend distributions may only be made after setting off the amounts previously paid.

If the advance profits distributed during corporate tax quarters exceed the final distributable profit, the excess must be covered by legal reserves, if available. If legal reserves are insufficient, shareholders must return the overpaid amounts. Companies must offset any advance profits distributed against the year-end profit before further dividend distributions.

Dividends paid to shareholders are subject to a 15% withholding tax if the recipients are resident individuals, non-resident individuals, or non-resident entities without a permanent establishment or representative in Türkiye. Under Turkish income tax law, distributions in the form of bonus shares are exempt from taxation.

A reduced rate applies when a double taxation treaty exists between Türkiye and the shareholder's country of residence and stipulates a lower withholding tax rate.

Dividend income received by a resident entity from another resident entity is exempt from withholding tax and benefits from a corporate tax exemption at the receiving entity's level.

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