



Türkiye: Funding of Joint Stock Companies

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I. Introduction

Shareholders may contribute funds to the company depending on liquidity needs of the joint stock company. From the corporate law perspective, such contribution may be made by the existing shareholders through share capital injection into the company, by the new shareholders through entering the company to acquire shares which will also lead to share capital increase or by granting loans to the company. This article will focus on these methods providing cash inflow by shareholders to the private joint stock companies that have adopted the fixed share capital system.

II. Share Capital Increase of Existing Shareholders

Existing shareholders of a company may inject funds into the company through a share capital increase. This share capital may be contributed by all shareholders collectively or by a specific group of shareholders.

A capital increase may be carried out by (i) issuing new shares, (ii) increasing nominal value of existing shares, or (iii) issuing premium shares by general assembly's resolution which will be registered with the trade registry.

If new shares are issued, relevant shareholder which subscribed for the corresponding share capital becomes the holder of the new shares issued. If dilution of shares is not desired and existing shareholding ratios should be maintained, each shareholder would need to subscribe to share capital increase pro rata to their shareholding in the company.

Another method accepted in the legal practice is to increase share capital by increasing the nominal value of existing shares, although this method is not directly regulated in Turkish Commercial Code No. 6102 ("TCC"). If this method is preferred, no new shares will be issued and only the nominal value of the shares will change. Despite the lack of new shares, as a rule regular formalities for share capital increase must be fulfilled. The difference is, unlike a regular capital increase process, general assembly must unanimously resolve on such capital increase and decide not to issue new shares¹. In the event that the nominal value of all shares is increased, the shares will not be diluted.

Alternatively, share capital may be increased through issuance of premium shares, which means issuing new shares at a value higher than their nominal value. Accordingly, share capital may be increased

¹ Erdoğan Moroğlu, Anonim Ortaklıklarda Sermaye Artırımı [*Share Capital Increase in Joint Stock Companies*], 4th Edition, On İki Levha Yayıncılık, 2018 at 193.

without changing the nominal value of the shares. For this, the company's articles of association or the general assembly must specifically allow the issuance of premium shares. Shareholders attending the share capital increase must fully subscribe share capital and premium amounts. The entire premium amount should be paid to company's bank account before the registration of the capital increase with the trade registry, together with the payment of at least 25% of the share capital increase amount. For this method, it should be considered by the shareholders that premium amounts can only be used for specific purposes since they will be included in the legal reserves, if not used for the expenses of newly issued shares, amortization and charitable contributions (after 5% of the net profit set aside as legal reserve until it reaches 20% of paid portion of the share capital). If legal reserves do not exceed 50% of share capital of the company, they can only be used to cover losses, to sustain the business during difficult times, or to prevent unemployment and mitigate its consequences.

The key condition for a capital increase through a share capital subscription is that the cash value of the company's shares is required to be wholly paid by shareholders. In other words, shareholders cannot subscribe for new shares unless their prior debts and company's share capital amount are fully paid. Another condition is that if the balance sheet of company contains funds that are allowed by legislation to be included to capital, first these funds must be converted into capital before share capital increase through share subscription.

As a general rule, at least 25% of the share capital increase amount must be paid into the company's bank account before the capital increase resolution is registered with the trade registry. As a matter of fact, depending on company's needs the entire amount of the capital increase may also be paid to the company in advance. If there is remaining amount, it must be paid within the subsequent 24 (twenty-four) months as of the registration of share capital increase with the trade registry. However, this paid amount cannot be used before the completion of registration before the trade registry. The transferred amount (25% or more) remains blocked in the company's bank account until the registration.

In practice, to evidence that the company's capital has been fully paid up to the trade registry, certified accountants should prepare report confirming that share capital of the company is fully paid and a letter from bank should be obtained to evidence that relevant portion of share capital increase has been paid to the bank account of the company before the registration. However, Article 456/1 of TCC allows for flexibility and non-payment of minor amounts that are not significant in relation to the share capital will not prevent a capital increase, in the case of share capital increase through share subscription.

Regarding the formalities of share capital increase, certain rules have been introduced in the TCC. Accordingly, joint stock companies that adopt the fixed capital system shall decide on the share capital increase by a general assembly meeting by a majority of the votes, where at least half of the capital is represented at such meeting and, as a rule, a representative of the Ministry of Trade would be required to participate in such meeting. In addition, depending on the type of capital increase, the board of directors must prepare a statement. The relevant general assembly resolution must be registered with the trade registry with supporting documents (*i.e. bank letter, accountant report, board statement*) within 3 (three) months.

III. Share Subscription by New Shareholder

Another alternative is to invite an external shareholder to subscribe to new shares. In this way, existing shareholders will continue to maintain their presence in the company, while an external shareholder will

be able to hold the newly issued shares and provide capital share to the company. To this end, the new shareholder will participate in the capital increase and acquire newly issued shares.

As a rule, existing shareholders have pre-emptive rights for newly issued shares. This right grants the existing shareholders the right to purchase newly issued shares in proportion to their existing shareholding in the share capital. However, these shareholders' pre-emptive rights may be restricted or waived by the general meeting if there are valid reasons. To adopt such resolution affirmative votes of the shareholders representing at least 60% of the share capital will be required. Therefore, first, pre-emptive rights should be eliminated. Then, new shareholder will be allowed to purchase newly issued shares once existing shareholder's pre-emptive right is ceased.

New shareholder is required to subscribe to the share capital by signing a written subscription letter. No records or conditions may be included in this letter, and it must contain the following components: (i) the number of shares subscribed, (ii) nominal value of shares, (iii) share type, (iv) share group, (v) amount paid in advance, (vi) the commitment period, and (vii) the issuance premium, if any, by referring to the share capital increase which grounds the subscription letter. Similarly, the registration procedure with the trade registry will be followed for this method, and the amount transferred to the company's bank account will not be available until the capital increase is registered with the trade registry.

IV. Granting Loans to Company

Another method for meeting the company's liquidity needs may be granting loans to company. This method may allow the company to receive funds quickly without undergoing the procedural requirements such as capital increase.

There is a lack of provision in TCC regarding granting loans to the company by shareholders, in other words indebtedness of company to shareholders. On the other hand, TCC somehow restricts the indebtedness of shareholders to the company but does not restrict indebtedness of company to the shareholders, and such debt relationship is governed by Turkish Code of Obligations No. 6098 ("TCO"). In doctrine², the legal basis of such debt relationship has been defined as "mutuum contract" (*tüketim ödöncü sözleşmesi*) pursuant to Article 386 of TCO. Under a mutuum contract, the shareholder, as the lender, undertakes to transfer the money to the company, and the company, as the borrower, undertakes to return the goods in the same quality and quantity.

Although there is no provision in TCC regulating the details of this debt relationship between the company and the shareholders, based on Article 457/2 of TCC, receivables of shareholders may later be converted into share capital through capital increase. Furthermore, Article 127 of TCC also allows receivables to be capitalized. Therefore, company can issue new shares in exchange for the debt it has received from the shareholder and pay its debt to the relevant shareholder through the shares. In this case, the capital increase procedure will also need to be implemented, and general assembly must convene to resolve on share capital increase. Specifically, among the supporting documents, the accountant report must indicate that the share capital increase amount will be covered through cash receivables of relevant shareholders.

² Hasan Pulaşlı, *Şirketler Hukuku Şerhi Cilt IV [Corporate Law Commentary Volume 4]*, 5th Edition, Adalet Yayınevi, 2024 at page 2901

Terms of the loan arrangement should also be reviewed from the tax perspective as per the thin capitalization rules, relevant bank as well as relevant trade registry directorate beforehand, as implementation rules may vary.

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