



## **A Rewarding Mechanism in Turkish Joint Stock Companies: Dividend Right Certificates**

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A company may wish to grant certain (mostly financial) rights to third persons without making them shareholders of the company and under Turkish law one way to achieve that purpose is issuing dividend right certificates.

Dividend right certificates can be issued both by private and public companies, however, this article will cover dividend right certificates issued by private joint stock companies, with particular focus on their types, the rights they confer to their holders, their issuance and the protection of the holders under the law.

Dividend right certificates provide their holders the rights listed in Article 503 of the Turkish Commercial Code No. 6102 (“TCC”), specifically non managerial shareholder rights. Article 503 of the TCC provides that dividend right certificates, regardless of their type, provide the right to **(i)** participate in the company’s profits, **(ii)** participate in amount remaining after liquidation and **(iii)** purchase the newly issued shares. A specific dividend right certificate may bear all or part of the rights stated above.

Notably, validity and enforceability of these rights do not strictly depend upon the issuance of a physical certificate. These rights arise from a contract between the company and the right holder and become effective upon the registration of the articles of association in the trade registry.<sup>1</sup> Once such right is granted to a person, a contractual relationship is established between the company and the holder, the certificate holders can assert their claims exclusively against the company itself, not against individual shareholders based on articles of association. These certificates can be issued for a specific period if that is also stipulated in the company’s articles of association.

#### **- Types of the Certificates**

There are 3 (three) types of dividend right certificates which are **(i)** founder dividend right certificates, **(ii)** ordinary dividend right certificates and **(iii)** participation dividend right certificates.

**Founder Dividend Right Certificates:** This type of certificate is issued exclusively to reward founders for their efforts in establishing a company. This is the most common type of dividend right certificates in practice.<sup>2</sup> Furthermore, since founder’s dividend right certificates are not attached to any share, it is possible for the founder to terminate its shareholding status by transferring its shares but still remain as a founder dividend right certificate holder.<sup>3</sup>

**Ordinary Dividend Right Certificates:** Ordinary dividend right certificate is issued in favor of the creditors of company and individuals affiliated with the company.

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<sup>1</sup> Sırakaya, Sermaye Şirketlerinde İntifa Senetleri, at page 217.

<sup>2</sup> İmregün, Kurucu Senetleri, at page 477; Pulaşlı, Şerh Cilt IV, at page 2730.

<sup>3</sup> Kendigelen, Kurucu İntifa Hakkı/Senedi/İtfa bedelinin Hukuki Niteliği, at page 179.

According to the prevailing view in the doctrine, individuals affiliated with the company aim to refer the individuals who provided benefit to the company.<sup>4</sup> Examples of such individuals include employees, officers, board members or departing shareholders who wish to be rewarded for their contributions to the company.

**Participation Dividend Right Certificates:** Participation dividend right certificates are issued by companies for a specific cash price to meet their financing needs. Since these certificates are issued in consideration of cash, the legislation does not restrict whom they can be issued. As this type of certificate is subject to capital markets regulations, it is excluded from the scope of this article.

#### - ***How to Issue the Certificate?***

To issue a dividend right certificate, articles of association must include a specific provision. This provision may be included in the article of association at the time of incorporation or may be added later through an amendment (*TCC Article 502*).

In addition to the specific clause to be provided in the articles of association, a specific general assembly resolution is also required to issue a dividend right certificate. Unless the articles of association requires a higher quorum, the general assembly meeting shall convene with the presence of shareholders (or their representatives) representing at least one-quarter of the share capital and the decision shall be given by the majority of the members present at the meeting (*TCC Article 418*).

Since the rights to be granted through the dividend right certificates holders are also the rights of shareholders, shareholders would be in a position sharing their rights with the certificate holders and restricting their own rights. Therefore, the rates regarding the participation in profit, in liquidation and the right to acquire newly issued shares of dividend right certificate holders must be clearly set forth in the articles of association to balance interests of the existing shareholders and certificate holders. While the TCC imposes a strict statutory limitation specifically regarding profit participation rate of founder's dividend right certificate holder under Article 348, the rates for other rights can be determined within the framework of freedom of contract. According to Article 348 of TCC, founder certificate payouts cannot exceed 10% of the remaining profit after deducting the legally mandated reserve fund and 5% statutory dividend for shareholders. Although the legislation does not specify the base capital for this calculation, legal doctrine indicates that the amount of profit to be paid should be calculated based on the existing share capital.

#### - ***Protection of Certificate Holders***

Once these rights are granted by the company, the company and/or its shareholders cannot unilaterally restrict or terminate these rights without explicit consent of their holders.

Also, unless a term is specified in the articles of association, the certificates only terminate upon the holder's consent or the company's dissolution. The law provides one exception: According to TCC 348/2 joint stock companies may cancel the founder's dividend certificates before offering their shares to the public. According to the prevailing view in the doctrine, this exception applies exclusively to founder's dividend right certificates.<sup>5</sup>

TCC also protects dividend right certificate holders during structural changes, such as mergers, demergers and conversions of legal form transactions. In such events, holders must be granted equivalent rights in the acquiring and/or the newly established company, depending on the type of the transaction as the case may be. If transaction companies fail to provide equivalent rights to the certificate holders, the dividend right certificates can be purchased by the acquiring company at their real value as of the date the merger agreement is concluded (*TCC Articles 140/5, 167/1-d, 183/3*).

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<sup>4</sup> Gürbüz Usluel, at page 136.

<sup>5</sup> Akdağ Güney (2014), at page 173; Hazıroğlu (2018), at pages 183-184.

Reasoning for Article 140/5 of the TCC emphasizes that the primary rule is to grant equivalent rights to the right holders and if that is not possible, only then purchasing the certificates at real value may become permissible.

The merger agreement to be prepared by the boards of directors of the companies involved in the transaction must explicitly set forth the specifics – including amount and payment terms in the case of a purchase – for granting the equivalent rights or purchasing the certificates (*TCC Article 146/1-c*). Furthermore, the merger documents must be made available to the certificate holders for their examination within 30 (thirty) days prior to the general assembly meeting regarding the structural change (*TCC Article 149/1*).

However, under Article 193 of TCC, if their rights are damaged during such changes, holders of dividend right certificates can file liability lawsuits against those who caused the damage with their negligence.<sup>6</sup>

- **Conclusion**

In conclusion, companies often aim to reward key contributors or compensate individuals by granting them specific financial privileges without conferring share ownership. Issuing dividend right certificates serves as an effective mechanism to achieve this exact purpose. However, given that the issuance of these certificates can have significant financial consequences for both the company and its existing shareholders, their exact scope, limits, and terms must be meticulously defined and detailed in the articles of association.

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(First published by Mondaq on April 14, 2026)

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<sup>6</sup> Özkök, Anonim Şirketlerde İntifa Senetlerinin Sağladığı Haklar, at page 171.