GENERAL ASPECTS OF CORPORATIONS AND LIMITED COMPANIES

UNDER TURKISH LAW

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PREAMBLE

This Article aims to give an introductory information on the legal structure of corporations and limited companies under Turkish Law. In accordance with this objective, only the essential legal elements of corporations and limited companies will be taken into consideration hereby. The legal framework of these both types of business enterprises will be analyzed briefly, insofar as they are to be treated as decisive criterions effecting the choice of foreign investors as to the form of business to be established in Turkey.

In compliance with the introductory character of this Article, a detailed information on the legal aspects of corporations and limited companies will not be given and only some general points will be explained.

Finally, it has to be noted that publicly held corporations which are governed by the Capital Market Act are excluded from that Article and consideration will be given only to the closely held corporations governed by Turkish Commercial Code.

I. INTRODUCTION

Under Turkish Law, the types of business enterprises with regard to the allocation of liability are classified, as follows:

a) Capital Companies[1]

b) Personal Companies[2]

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1 The term “capital company” refers to as the general concept for the business enterprises by which the legal and administrative background is based on the capital and by which the personalities of the shareholders do not have an important influence on the structure and operation of the enterprise.

2 The term “personal company” refers to as the general concept for the business enterprises by which the legal and administrative background is based on the personalities of the partners and which are characterized with the personal liability of their partners from the debts of the enterprise.

The personal companies such as the collective partnership[3] regulated in Turkish Commercial Code are characterized with the ancillary personal liability[4] of their partners for the debts owned by the partnership. This type of a company under Turkish Law is similar to the partnerships under Anglo-Saxon Law systems.

The capital companies under Turkish Law consist of two different types :

i) Corporations (Joint Stock Companies),

ii) Limited Companies.

The both types mentioned hereby are characterized with the limited liability of their shareholders. Because of the advantages attached to limited liability and a legal and administrative structure based upon the capital, these ones are the forms usually preferred by the investors who are willing to establish a business in big amounts, in order to avoid any personal risk.

Prior to our explanations relating to the main aspects of corporations and limited companies, it has to be emphasized that a foreign capital company may be established either in form of a corporation or in form of a limited company under Turkish Law. Therefore, foreign investors intended to establish a company in Turkey should choose one of these business types. In this regard, we will hereby only focus on the main aspects of these two types of capital companies.

It can be put into question for which purpose the legislation has regulated two different types of business forms based upon limited liability and capitalistic structure. To find the answer of that question, the main differences between these two types of capital companies should be taken into consideration.

In general, it can be said that limited companies are considered as an alternative to the corporations aiming to enable small and medium enterprises to enjoy the advantages of limited liability[5]. On the other hand, besides many small enterprises,

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3 Collective partnership is defined in Article 153 of Turkish Commercial Code : *" The collective partnership is such a partnership which is established between natural persons for the purpose of operating a commercial entreprise and, by which the liability of the partners is not limited against the creditors thereto."*

4 The personal liability of the partners by the collective partnership has an ancillary character. This principle is set forth in Article 179/I of Turkish Commercial Code, as follows : *" The partnership itself is liable from his debts at first instance. However, where any executive action against the corporation. results in failure thereof in payment or where the partnership is dissolved on any grounds, only the partner or both the partner and the partnership may be taken into legal action or civil execution."*

5 The regulations with respect to limited companies under Turkish Law are codificated from the Swiss Obligation Code. Therefore, the limited company under Turkish Law is similar to *"Gesellschaft mit beschränkter Haftung (GmbH)"* under Swiss Law. Since the *"Gmbh"* is the invention of the German legislature and even the swiss legislation on the Gmbh is influenced from the German legislation, it can be said that, the main aspects of limited companies under Turkish Law are also similar to

there are also a serious number of big enterprises established in form of a limited company in Turkey. Especially, where the shareholders of the company are not divided into different interest groups representing different capital sources, that is to say, where the capital is concentrated in only one economic power, the form of a a limited company appears as a considerable alternative, since such capital structure is not designed to give rise to internal conflicts with respect to important decisions relating to business. In such cases, the more flexible operation of limited companies brings about the preference of that form by the investors.

Nevertheless, if the company to be established intends to go public, the sole form to choose under Turkish Law is the corporation, as limited companies are not allowed for the public purchase. Finally, it has to be noted that whether publicly or closely held, the majority of the big business enterprises in Turkey are still established in form of a corporation.

II. Definition and General Aspects of Corporations Under Turkish Law

The corporations under Turkish Law are governed by the Articles 269-474 of the Turkish Commercial Code[6]. Art. 269 of Turkish Commercial Code gives the definition of a corporation, as follows:

"A corporation is a company which has its own trade name and a predetermined amount of capital divided by shares and which is liable for his debts only with its assets."

The second paragraph of Art. 269 describes the liability of the shareholders, as follows :

" The liability of the shareholders is limited to the capital shares they have subscribed for."

Taking the provisions above into consideration, the main aspects of the corporations may be classified, as follows :

- The stated capital invested for the corporation shall be determined in a certain amount by the articles of incorporation. This amount refers to as "the nominal capital" of the corporation.

German *"Gmbh"*. The best fact verifying the german influence on this type is the great number of *GmbH*'s located in Germany. Besides that, most of the German investors in Turkey are also operating enterprises established in form of a limited company.

6 Most of the provisions relating to corporations under Turkish Law are codified from the Swiss Law of corporations which in force prior to 1992. Hereby, it should be noted that, many provisions of the Swiss Obligation Code relating to corporations have been amended in 1992 and the recent legal regulation on swiss corporations is quite different as the Turkish Law of corporations at the moment.

- The nominal capital of the corporation is divided into shares of equal value which are treated as negotiable instruments and therefore, which can be subject to legal transactions. Reflecting the typical legal nature of a capital company, the corporation's structure is based upon the shares and the capital consisting thereof, not upon the persons participated in the capital. Accordingly, the shares may be easily transferred, pledged or disposed in any other forms by their owners without the requirement of the the consent of the corporation or other shareholders.
- The liability of the shareholders against the corporation is limited to the amount of the capital share which they have subscribed for under the articles of incorporation. That means, when the shareholder has paid the total amount of his or her subscription for shares to the corporation, he or she would be deemed to be relieved from all his obligations against the corporation.
- The liability for the debts of the corporation belongs only to the corporation itself. That is to say, the shareholders are not liable for the debts of the corporation and therefore, the creditors of the corporation do not have any right of claim against the shareholders with respect to the debts of the corporation.

Finally, it can be concluded that the corporation in its legal structure includes all the main aspects of a capital company, such as the limited liability or the free transferability of the shares.

III. Definition and General Aspects of Limited Companies Under Turkish Law

Under Turkish Law, the limited companies are governed by Articles 503-556 of Turkish Commercial Code. Art. 503 defines "the limited company", as follows :

" A company established by two or more natural or judicial persons under a trade name, having a predetermined amount of a nominal capital and consisting of shareholders whose liability is limited to the amount of the capital undertaken by them, is referred to as the limited company"

Like corporations, also limited companies reflect the main aspects of capital companies in their legal structure. This is especially characterized in the limited liability of the shareholders to the amount of their capital against the company and the exclusion of liability of the shareholders against the creditors of the company (except for the liability for the public revenues such as taxes, as will be explained more detailed below). Despite the similarity of both types, some aspects of the limited companies are different from the corporations. Because of this differences, which will be described in the following chapter, the nature of a capital company by the limited companies does not appear to be so clear as the corporations. The fact that some

matters relating to limited companies are regulated similar to personal companies under Turkish Law, verifies the less capitalistic and more personalistic nature of the limited companies in relation to corporations.

As a conclusion, it can be said that, the limited companies under Turkish Law are capital companies with regard to the allocation of the liability, but also include some personal elements aside from the corporations. For the better understanding of the subject matter, we will focus on the main differences between corporations and limited companies under Turkish Law in the following.

IV. The Main Differences Between Corporations and Limited Companies

1. Legal Ability to Issue Negotiable Instruments such as Share Certificates or Debentures

Under Turkish Law, the corporations are allowed to issue negotiable instruments[7] such as the share certificates[8] or debentures. Aside from the corporations, the limited companies may not issue share certificates or debentures having the legal nature of a negotiable instrument[9]. In case where a limited company issues certificates relating to its shares, these shall be deemed to be only a means of proof for title of shareholdership, but not a negotiable instrument representing the shares as it is the case by the corporations[10]. The legal framework described hereby demonstrates that free transferability is fully guaranteed under law by the corporations, where the limited company shares are deprived of enjoying the free circulation of the capital by negotiable instruments.

2. Free Transferability of Shares

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7 "Negotiable Instrument" is defined under Art. 557 of Turkish Commercial Code, as follows : *"The negotiable instruments are such instruments representing a right which can not be transferred to other persons or claimed without the instrument itself"*. That is to say, the right attached upon the negotiable instrument may be transferred or exercised only by the physical delivery or submission of the instruments. The share certificates issued by the corporations representing the shareholder's rights are also negotiable instruments in their legal nature.

8 On the other hand, the corporations are not obliged to issue stock certificates under Turkish Law. The emission of share certificates is only an option for the corporation and also the shareholders can not force the corporation to issue share certificates. In the case where the corporation does not issue share certificates the transfer of the shares requires only a written agreement concluded between transferer and transferee.

9 Turkish Commercial Code Article 503 (2)

10 Turkish Commercial Code Article 518 (3)

As described briefly above, the corporation shares enjoy the ease of transferability, where the transfer of limited company shares is attached upon a strict formal procedure in relation to transfer of corporation shares.

a) Transfer of the Corporation Shares

i) Where the corporation shares are represented by share certificates, the form of the transfer depends upon the type of the certificates.

- The transfer of *the share certificates to bearer*[11]requires only the delivery of the certificate to the transferee[12].

- The transfer of the *registered share certificates* requires both the delivery and the endorsement of the certificate to the transferee[13]. Thereafter, the registration of the transferee to the share book.

- Where the corporation shares are not represented by share certificates, they can be transferred only by a written agreement concluded between the transferor and the transferee.

Finally, it has to be noted that, various restrictions may be imposed on the transfer of the registered shares by stipulations set forth in the articles of incorporation[14]. In this way, it is possible to attach the transfer of the corporation shares upon the consent of the board of directors. On the other hand, any restriction on the transfer of the share certificates to bearer is not valid in law at all.

b) Transfer of Limited Company Shares

The transfer of limited company shares requires both, i)the conclusion of a written agreement certified by a notary and, ii) the approval of the shareholders owing at least 75% of the capital and consisting at the same time 75% of the number of the shareholders.

In this context, it has to be concluded that, the transfer of shares is much easier by corporations in relation to limited companies.

3. Going Public

Under Turkish Law, only the business enterprises established in the form of corporation are allowed to issue stocks for public purchase. Contrary to the corporations, the limited companies may not go public.

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11 It has to be noted that share certificates to bearer may be issued only to represent the shares paid in full amount to the corporation under Turkish Law. See Turkish Commercial Code Section 409(3).

12 Turkish Commercial Code Article 415

13 Turkish Commercial Code Article 416 (2)

14 Turkish Commercial Code Article 416 (1)

It has to be noted that publicly held corporations under Turkish law are governed by Capital Market Act[15]. Therefore, the legal framework of publicly held companies is different from closely held corporations in many aspects. A corporation which is established as a publicly held one or which has been converted into such one by a public offering after its establishment, shall take the provisions of the Capital Market Code into account.

4. Liability For Public Revenues

a) Liability For Public Revenues by Limited Companies

By limited companies, even though the limited liability of the shareholders is recognized in general under Turkish Law, the public revenues are excluded from that principle. That is to say, the shareholders of limited companies are personally liable from public revenues such as taxes, social security premiums and other fees and duties owed by the company up to the extent of the amount of his or her capital in the company[16]. Accordingly, where the company fails to fulfill its duties with respect to public revenues, these can be recovered from the shareholders.

For avoidance of doubt, it should be noted that the personal liability of the shareholders of limited companies for the public revenues is only an exception to the general rule which provides the exclusion of personal liability of the shareholders for the debts owed by the company.

The personal liability of the shareholders of limited companies for the public revenues is also limited with the amount of their capital. Nevertheless, this differs from the limitation of liability in its real sense, as personal liability for the debts of the company is subject of the limitation hereby.

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15 Act (Nr. 2499)

16 Recovery of Public Revenues Act (Nr. 6183) Article 35

b) Liability For Public Revenues by Corporations

Under Turkish Law, the shareholders of a corporation are not held personally liable for any debt owed by the company, including the public revenues.

On the other hand, only the legal representatives of a corporation may be held personally liable for the public revenues such as taxes, social security premiums and any other fees and duties[17]. The legal representative refers to as *the members of the board of directors which are duly empowered to represent the corporation*.

The representatives are liable for taxes owed by the corporation in case where those can not be recovered from the corporation. The liability of directors is ancillary to that of the corporation. Therefore, the taxation authorities may request to the representatives for the public revenues only subsequent to the corporation's failure in paying them. However, only the social security premiums may be recovered directly from the members of the board of directors[18].

5. The Number of Shareholders

Corporations shall consist of at least 5 (five) shareholders, whether natural or judicial persons.

Limited companies shall consist of at least 2 (two) and not more than 50 (fifty) shareholders, whether natural or judicial persons.

6. The Amount of The Capital

The overall nominal share capital of a *corporation* must be a minimum of 5.000.000.000 (five billion) TL. In addition, the minimum capital contribution by each foreign shareholder must be at least $ 50.000.

The overall nominal share capital of a *limited company* must be a minimum of 500.000.000 (five hundred million) TL. In addition, the minimum capital contribution by each foreign shareholder must be at least $ 50.000.

7. The Operation of the Internal Affairs by Corporations and Limited Companies

a. Statutory Bodies

aa. Statutory Bodies of a Corporation

The General Board which consists of all the shareholders fulfils the function of making important decisions relating to the corporation, such as the amendments to the articles of incorporation, election of the members of the board of directors and

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17 Taxation Procedure Act (Nr. 213) Article 10

18 Social Security Act Article 80 (11)

auditors, release of the members of the board of directors from their liability against the corporation and approval of the balance sheet and annual report supplied by the board of directors.

The general board meetings of the corporations require the fulfillment of a great deal of formalities such as the consignment of an invitation letters to the shareholders or the presence of a commissaire authorized by the Ministry of Industry and Commerce.

The Board of Directors is the administrative and representative body of the corporation[19]. The board of directors shall consist of at least 3 (three) members who ought to be shareholders and natural persons. Judicial persons are not allowed to be member of the board of directors under Turkish Law. The shareholders which are judicial persons may be represented in the board of directors by their representatives who shall be natural persons.

The first members of the board of directors shall be designated by the articles of incorporation. Thereafter, the following members shall be appointed by the general board[20]. The members of the board may be eliminated by the General Board at any time prior to the end of their office[21].

The board of directors may not be elected for more 3 (three) years. The same members may be elected again unless otherwise stipulated in the articles of incorporation[22].

The board of directors represents the corporation in its business transactions engaged in with third parties. Under Turkish Commercial Code, for any transaction carried out on behalf of the corporation to be binding for the corporation, the signature of at least two members of the corporation are required[23]. On the other hand, the rule in question may be modified by the articles of incorporation. For example, the power to represent the corporation may be granted to one member by solely his or her signature. Nevertheless, it has to be noted that only two forms of limitation with respect to the power of representation granted to directors are allowed under Turkish Law. These are, as follows[24] :

i) The limitation of the power of representation to the transactions of any branch of the corporation,

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19 Turkish Commercial Code Article 317

20 Turkish Commercial Code Article 312 (1)

21 Turkish Commercial Code Article 316 (1)

22 Turkish Commercial Code Article 314 (1)

23 Turkish Commercial Code Article 321 (3)

24 Turkish Commercial Code Article 321 (2)

ii) the requirement of signing of the transactions by any number of the directors jointly.

Any other limitations of the power of representation except for the ones cited above are not valid in law and can not be claimed against third parties who engaged in a transaction with the corporation[25].

The meetings of the of the board of directors do not require the fulfilment of strict formalities. The quorum required for the meeting consists of at least one more of the half of the member's number[26]. The decisions shall be taken by the votes of the majority of the present members. Nevertheless, the decisions may be taken solely by the written consent of the members without having a meeting unless any of the members calls for a meeting[27].

The Auditors are the supervisory bodies of the corporation. The corporations shall have at least one and not more than five auditors. In case where more than one auditor is elected, all the auditors shall constitute a board of auditors[28].

The auditors are elected by the general board. The first auditors shall be elected for 1 (one) year by the first general board meeting. The following auditors shall be elected by the general board for at most three (3) years[29].

The auditors shall be Turkish citizen under Turkish Law. Where more than one person has been elected to act as an auditor, their majority shall be Turkish citizens[30].

In general, the auditors fulfill the function of a supervisory body in the organization of the corporation. On the other hand, the Turkish Law does not require a statutory supervision carried out by independent auditors for the closely held corporations. In addition, the influence of the auditor as a statutory body under Turkish Commercial Code is not very essential with respect to the administration of the company.

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25 Turkish Commercial Code Article 317 (2)

26 Turkish Commercial Code Article 330 (1). The quorum in question hereby does not refer to as "the majority". According to the precedent of Turkish Supreme Court, the quorum for the meeting of a board of directors with 5 members consists of at least 4 members.

27 Turkish Commercial Code Article 330 (2)

28 Turkish Commercial Code Article 347 (1)

29 Turkish Commercial Code Article 347 (2)

30 Turkish Commercial Code Article 347 (3)

bb. Statutory Bodies of a Limited Company

General Board : Where the number of the shareholders is more than 20 (twenty), the provisions governing the general board meetings of corporations apply also to those of the limited companies by reference[31]. On the other hand, where the number of the shareholders of the limited company is not more than 20, as it is usually the case, general meetings of the limited companies may be carried out without the fulfillment of the formal requirements provided for the corporations. In this case, the decisions of the general board may be taken only by the written consent of the shareholders[32].

Directors : Under Turkish Law, the limited companies do not have a board of directors as a statutory body. However, the limited companies are administrated and represented by one or more directors designated by the articles of incorporation or elected by the general board[33].

Similar to corporations, judicial persons are not allowed to act as a director of a limited company under Turkish Law. In such cases, the natural persons empowered to represent the shareholder which is a judicial persons shall be registered and published as a representative and fulfill the functions of a director[34].

The legal regulation relating to the power or representation by corporations which has been cited above applies also to the directors of limited companies by reference[35].

By limited companies, the director(s) does not have to be a shareholder. Any natural person may be elected as a director[36]

Auditors : The limited companies consisting of more than 20 shareholders are required to have at least one auditor. In this case, the same provisions governing the auditors of the corporation shall apply also to the limited companies[37].

The limited companies consisting of not more than 20 shareholders are not required to have an auditor as a statutory body under law. In this case, the shareholders, with the exclusion of the ones acting as a director, have the right to

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31 Turkish Commercial Code Article 536 (1)

32 Turkish Commercial Code Article 536 (2)

33 Turkish Commercial Code Article 540 (2). Where no directors are designated by the articles of incorporation or elected by the general board, all the shareholders shall be deemed to be the directors. See Turkish Commercial Code Article 540 (1).

34 Turkish Commercial Code Article 540 (4)

35 Turkish Commercial Code Article 542 (1)

36 Turkish Commercial Code Article 541

37 Turkish Commercial Code Article 548 (1)

request information from the directors and inspect the commercial records of the company subject to certain circumstances[38].

b. Quorums for the General Meeting

aa. The Importance of the Quorums

Since the ability to influence the important decisions relating to the operation of the entreprise is essential for the control of the business, the quorums required for the general board decisions have to be known in order to structure the capital in such a way which enables the sole control of the business.

There are two kinds of quorums under Turkish Law. *The quorums required for the meetings* refer to as the minimum proportion of all the shareholders ought to be present in the meeting so that the meeting and the decisions taken thereby can be considered in accordance with law. *The quorums required for the decisions* refer to as the minimum proportion of the present shareholders in the meeting who have to vote in favor of any offer so that a decision may be taken by the general board in accordance with law.

bb. Quorums for the General Board of Corporations

The most important *quorums required for the meetings* of the general board with respect to various matters are, as follows :

- The decisions relating to modifications of the activity field of the corporation and the termination of the corporation require the presence of the shareholders owning at least two-third (2/3) of the capital share. In case where the quorum in question can not be reached at the first meeting, the presence of the shareholders owning at least the half (1/2) of the capital is required in the following second meeting[39].

- The decisions relating to amendments to the articles of incorporation, such as the capital increase or capital reduction, require the presence of the shareholders owning at least the half (1/2) of the capital share. In case where the quorum in question can not be reached in the first meeting, the presence of the shareholders owning at least the one-third (1/3) of the capital is required in the following second meeting[40].

- For any other decision except for the ones cited above, the presence of the shareholders owning at least the one-fourth (1/4) of the capital share is required. In

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38 Turkish Commercial Code Article 548 (2)

39 Turkish Commercial Code Article 388 (2)

40 Turkish Commercial Code Article 388 (2)

case where the quorum in question can not be reached in the first meeting, a second meeting has to be held without the requirement of any quorum to be reached[41].

In any of the cases cited above, *the quorum required for the decisions of the general board to be taken* consists of the votes of the majority of the shareholders. That means, in any of the cases cited above, *the majority of the present shareholders* in the meeting has to vote for the offer relating to the decision so that a valid decision can be taken by the general board.

As a conclusion, it can be said that owning a majority of the capital shares is usually necessary and enough to control a corporation under Turkish Law. On the other hand, it should be noted that a serious number of rights referred to as "minority rights" which allow to influence some important decisions of the corporation, such as the release of the directors or the approval of the balance sheet, have been granted to shareholders owning 10 % of the capital by Turkish Commercial Code[42].

cc. Quorums for the General Board of Limited Companies

There are only *quorums required for the decisions* with respect to limited companies. That means, the shareholders owning a certain proportion of the capital must vote for the offer relating to the decision.

- The decisions relating to amendments to the articles of incorporation, such as the capital increase or capital reduction shall be taken by the votes of the shareholders owning at least two-third (2/3) of the capital[43].

As a conclusion, it can be said that the control of a limited company requires the ownership of at least 2/3 of the shares. On the other hand, it has to be noted that, like the corporations, minority shareholder having 10 % of the capital are having many rights capable of influencing the administration of the company.

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41 Turkish Commercial Code Article 372

42 By publicly held corporations, the proportion of the shares required for the exercise of the so called "minority rights is determined as 5% of the stated capital. See Capital Market Act Art. 11/VIII.

43 Turkish Commercial Code Article 513 (1)

CONCLUSION

Both corporations and limited companies fit to the needs of investors with respect to avoidance of personal liability and offer the legal grounds on which the advantages of limited liability can be realized. On the other hand, the operation of limited companies is much cheaper and more flexible in compare to corporations. However, where the business enterprise to be established is based on a joint venture consisting of different capital sources, the form of corporation is recommended since it offers the ideal type for business enterprises operated by different capital groups with an equal influence on the operation of the company. Limited companies, on the other side, are recommended for the business enterprises owned and operated by only one economic power since the procedure of decision-taking and transfer of the shares require the control over more than the majority of the shares.