

An Evaluation of the Recommendations on Eli Guidance on Company Capital and Financial Accounting for Corporate Sustainability From the Perspective of Turkish Corporate Law*

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Öz

Avrupa Hukuk Enstitüsü'nün Kurumsal Sürdürülebilirlik için Şirket Sermayesi ve Finansal Muhasebe Hakkında Rehberi, şirket özsermayesinin kurumsal sürdürülebilirlik sağlanmasındaki önemine dikkat çekmesi ve şirketlere bu yönde rehberlik etmesi bakımından önem taşımaktadır. Bu çalışma ile kurumsal sürdürülebilirliğin yerleşmesi ve şirketlerin özsermayelerinin bu yönde kullanılabilmesi adına yol gösterici tavsiyeler barındıran bu Rehber'in Türk Hukukundaki yedek akçeler ve kâr dağıtımına ilişkin düzenlemelerle bir karşılaştırması yapılarak Türk Hukuku'nun tanıtılması amaçlanmıştır.

Anahtar Kelimeler: Özsermaye, Kurumsal Sürdürülebilirlik, Kanuni Yedek Akçe, Zorunlu Kâr Dağıtımı

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Abstract

ELI Guidance on Company Capital and Financial Accounting for Corporate Sustainability is important as it draws attention to the importance of company equity in achieving corporate sustainability and provides guidance to companies in this direction. This study aims to introduce Turkish Law by comparing this Guideline, which contains guiding recommendations for the establishment of corporate sustainability and the use of companies' equity in this direction, with the regulations on reserves and profit distribution in Turkish Law.

Key Words: *Equity Capital, Corporate Sustainability, Legal Reserves, Mandatory Dividend Distribution*

Extended Summary

Published in 2023, the ELI Guide aims to provide a framework for understanding corporate sustainability in business and law, addressing issues for European and national regulators, and offering company law tools for solutions. It seeks to modernize European company law, particularly regarding profit distribution, equity protection, and undistributed reserves, covering areas such as equity taxonomy, sustainable equity management, accounting calculations, and director duties. The study specifically compares the Guideline's recommendations with Turkish regulations on reserves and profit distribution.

Sustainability is broadly defined, encompassing economic, environmental, and social dimensions, without a single universally accepted definition. The Brundtland Commission (1987) defined sustainable development as meeting present needs without compromising future generations' ability to meet their own. Corporate sustainability, in this context, refers to businesses integrating economic, social, and environmental factors into their core activities and decision-making to create long-term value. The ELI Guideline defines corporate sustainability as a company's capacity to continue existence (going concern principle), providing satisfactory products/services, paying stakeholders (employees, shareholders), meeting obligations, and contributing to wider social and environmental interests. This definition links corporate sustainability with corporate social and environmental responsibility, emphasizing that financially thriving companies also fulfil broader societal and environmental obligations.

In company law, capital is a fundamental element, representing the predetermined value shareholders undertake to bring to the company. Equity capital, distinct from capital, represents the difference between total assets and liabilities and includes paid-in share capital, reserves, and unpaid profits. The principle of capital preservation in joint-stock companies aims to prevent arbitrary disposal of capital, protecting creditors' interests. However, sustainability shifts this perspective, considering interests beyond shareholders and creditors, encompassing broader societal and environmental goals, including those for future generations.

The ELI Guideline offers five key recommendations for sustainable equity capital.

The Guideline suggests a dual test for distributions: sufficient realized distributable retained earnings/reserves before distribution, and shareholders' equity capital at least equal to statutory paid-in capital and undistributable reserves after distribution. It also recommends a publicly disclosed board policy for equity management, balancing stakeholder interests and social/environmental responsibilities. Turkish Law generally aligns with these, prohibiting dividend distribution from legally protected assets. TCC Article 509 allows distributions only from net profit and free reserves (pre-distribution test). TCC Article 519 ensures a post-distribution test by mandating legal reserves (5% of annual profit until 20% of paid-in capital), which can only be used for specific purposes like covering losses or continuing business. Additionally, Capital Markets Board principles and Sustainability Principles Compliance Frameworks emphasize stakeholder benefits and public disclosure of related managerial strategies.

The Guideline proposes extending precautionary principles from regulated sectors (like banking) to other companies to ensure corporate sustainability. This could involve restricting distributions if reserves fall below a threshold or determining a maximum annual distribution amount. Turkish Law's system of legal reserves (TCC Arts. 519, 523) helps balance interests by mandating initial reserve allocation for the company's benefit while securing a basic dividend right for shareholders. Further, it allows for additional legal reserves from distributions to non-shareholder beneficiaries and discretionary reserves for employees or charitable organizations.

The Guideline advises treating share premiums as regulatory capital, subject to distribution and capital reduction restrictions, aligning with EU Directive 2017/1132. In Turkish Law, TCC Article 519/2(a) stipulates that unused portions of share premiums (after issuance expenses, redemption provisions, and charitable payments) must be added to legal reserves, contributing to social benefit.

The Guideline suggests establishing and maintaining reserves to safeguard a company's ability to continue economic transactions, beyond minimum statutory capital, to facilitate corporate sustainability, including

social and environmental responsibilities. Turkish Law mandates meaningful minimum capital for companies (TCC Art. 332, 580). It also allows for general assembly decisions to allocate reserves for charity funds for employees or other charitable purposes (TCC Art. 523/3, 522). Reserves for acquired own shares and revaluation funds are also stipulated for sustainability purposes (TCC Art. 520).

The Guideline recommends expanding the scope of legal reserves to better meet social and environmental responsibilities, basing requirements on total shareholders' equity capital (including agio), with minimum annual allocations set by law or general meeting. The Turkish Commercial Code's legal and discretionary reserve fund system is aligned with this, adding premiums and strike-off proceeds to legal reserves without upper limits. Discretionary reserves can also be set aside by board proposal or general assembly resolution (TCC Arts. 521, 523).

In conclusion, the ELI Guideline highlights the importance of equity capital for corporate sustainability. Turkish Law, through its regulations in the Turkish Commercial Code, generally provides sufficient mechanisms for the provision, protection, and utilization of equity capital to meet the requirements of corporate social responsibility envisioned by the Guideline, observing a balance of interests for all participants. While there are differences, these often stem from the differing economic purpose of capital companies versus the broader social interests corporate social responsibility aims to protect. For instance, a mandatory upper limit on profit distribution, as suggested by the Guideline, would conflict with the core economic purpose of capital companies in Turkish Law, which already balances interests through its reserve and dividend system. Similarly, mandatory segregation of reserves could impose financial burdens and restrict shareholder dividend expectations.

Introduction

In 2023, the European Law Institute¹ (ELI) published a Guide on Company Capital and Financial Accounting for Corporate Sustainability² (“Guide”), followed by an unofficial Turkish translation of the Guide in 2024³.

The purpose of the Guideline is set out on the Institute’s official website as providing a frame of reference and analysis for understanding corporate sustainability in the context of business and law, pointing to specific issues that need to be addressed by European and national regulators, and creating a set of company law tools that set out possible solutions for dealing with these issues⁴, aiming to modernize European company law in terms of its rules on profit distribution, equity protection and undistributed reserves.

The guidance includes a taxonomy for company equity, as well as recommendations on sustainable equity management, accounting calculations, group and related party transactions, national and cross-border transactions, structural changes, and the duties of directors and auditors.

This study aims to introduce Turkish Law by comparing this Guideline, which contains guiding recommendations for the establishment of corporate sustainability and the use of companies’ equity in this direction, with the regulations on reserves and profit distribution in Turkish Law.

In order for the reader to fully understand the subject, initially, very brief information about sustainability and corporate sustainability will be given; the concepts of capital and equity and the principle of capital preservation will be briefly explained, taking into account its relationship with

1 The European Law Institute is an independent non-profit organization for the advancement of European Law. For more information see <https://www.europeanlawinstitute.eu/about-eli/>

2 <https://www.europeanlawinstitute.eu/projects-publications/publications/eli-guidance-on-company-capital-and-financial-accounting-for-corporate-sustainability/#:~:text=The%20ELI%20Guidance%20proposes%20a,need%20to%20be%20addressed%20by>

3 https://www.europeanlawinstitute.eu/fileadmin/user_upload/p_eli/Publications/ELI_Guidance_on_Company_Capital_and_Financial_Accounting_for_Corporate_Sustainability_Final_Turkish_Translation.pdf

4 See also Guide p. 16 et seq.

sustainability, and then the taxonomy and recommendations included in the Guide for the purpose of ensuring sustainable equity will be introduced and comparisons with Turkish Law will be made.

I. Sustainability, Corporate Sustainability and Capital Preservation Principle

A. Sustainability

It can be stated that the definition of sustainability is quite broad. Looking at the historical process⁵, it is observed that economic and environmental dimensions have been studied more intensively, but today it is accepted that sustainability has three basic dimensions: economic, environmental, and social⁶.

In this context, it should be noted that there is no single definition of sustainability⁷.

In 1987, the United Nations put forward a definition of sustainability from a development perspective: “Sustainable development is development that meets the needs of the present generation without compromising the ability of future generations to meet their own needs. It is an economy in which natural resources are used only to the extent that they can be reproduced” (Brundtland Commission definition)⁸.

5 For the historical process of the concept of sustainability, see Massimiliano Montini, Designin Law for Sustainability, *Sustainability and Law General and Specific Aspects*, ed. Volker Mauerhofer/Daniela Rupo/Lara Tarquinio, Springer 2020, pp. 34 et seq.

6 Hatice Kübra Kandemir, “Sürdürülebilir Şirketler ve Hukuki Çerçevesi”, *İstanbul Ticaret Üniversitesi Sosyal Bilimler Dergisi*, 20(41), pp. 853-876, p. 856.

7 On the broad range of the concept, from environmental protection to bio-diversity, sustainable activities, fair working conditions, and even sustainable profit, see Michael D’heur, *shared.value.chain: Profitable Growth Through Sustainable Value Creation*, in *Sustainable Value Chain Management Delivering Sustainability Through the Core Business*, ed. Michael D’heur, Springer 2015, p. 1 et seq.

8 For other definitions, see Kandemir, p. 857 et seq; Işık Özer, Anonim Şirketlerde Kurumsal Sosyal Sorumluluk, *Adalet* 2022, p. 33; Beate Jafell, Christopher M. Bruner, Corporations and Sustainability, *The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability*, Cambridge 2020, pp. 7 et seq.; Deniz Okuyucu, Anonim Şirketin Sosyal Sorumluluğu, *Oniki Levha* 2023, p. 59; Fatma Beril Özcanlı, Sürdürülebilirlik İlkesi Açısından Anonim Ortaklık Yönetim Kurulunun Stratejik Kararları ve Raporlama, *Prof. Dr. Tuğrul Ansay Anısına: Anonim Şirketler Hukukunun Gelecek On Yılı*, ed. Emek Toraman Çolgar, Cem Veziroğlu, Abdurrahman Kayıklık, *Onikilevha* 2023, pp. 75-100, p. 76.

B. Corporate Sustainability

In the understanding of sustainability, which takes the continuous satisfaction of human needs at its center, the system that businesses will follow while continuing their activities is expressed as corporate sustainability⁹.

In the doctrine, according to Özer, corporate sustainability means that “companies’ incorporation all economic, social and environmental factors into their core activities, production processes and decision-making mechanisms in order to create value in the long term”¹⁰.

Demirel Özdemir defines corporate sustainability as “the adaptation of corporate governance principles to the decision-making mechanisms of companies with the aim of creating long-term sustainable value, managing environmental, social, and governance/corporate governance (ESG) risks that may arise from these issues and fulfilling certain obligations”¹¹.

The Guideline provides a definition of corporate sustainability as well¹². Accordingly, it means *a company’s capacity to continue in existence in the future (the going concern principle) and, accordingly, to continue its activities with a view to: (i) providing satisfactory products and services to its customers; (ii) satisfactorily paying for the rights of stakeholders, including employees and shareholders; (iii) meeting its credit and debt obligations; (iv) and contributing to wider social and environmental interests through the company’s social and environmental responsibilities.*

It is stated that this definition combines corporate sustainability with corporate, social, and environmental responsibility, and that financially thriving companies are those that are able to finance not only corporate or shareholder interests, but also the demands of other stakeholders, as well as fulfill broader social and environmental responsibilities.

9 Özer, p. 34.

10 The author also evaluates corporate sustainability in terms of stakeholder theory and legitimacy theory; Özer p. 35 et seq.

11 Duygu Demirel Özdemir, Kurumsal Sürdürülebilirlik Kavramı Çerçevesinde 2024/1760 Sayılı Avrupa Birliği Kurumsal Sürdürülebilirlik Özenli Etki Değerlendirmesi Yönergesi (CSDDD) Hükümlerinin Değerlendirilmesi, Regesta, Vol. 9, No. 3, 2024, pp. 537-590, p. 553.

12 Guideline, p. 20.

Although they are used interchangeably, sustainability is a different concept from corporate social responsibility¹³. On the other hand, with these explanations, it is understood that the concepts of sustainability and corporate sustainability, as well as corporate social responsibility, show themselves in an inseparable transitivity with each other in company management.

In 2011, the Europe 2020 strategy was revised, and it was stated that corporate social responsibility means that businesses are responsible for their impact on society¹⁴.

Corporate social responsibility, like sustainability, has been a concept that has been handled from different perspectives, and in the doctrine, it has been interpreted together with the economic purpose of capital companies and by harmonizing this purpose with the social and environmental perspective of the concept of sustainability, and in this respect, it has been tried to be defined with narrow and broad meanings in some places¹⁵.

C. Equity Capital and Capital Preservation Principle From a Sustainability Perspective

1. Equity Capital and Taxonomy

The concept of capital has different equivalents in accounting, finance, law, and even in the flow of daily life¹⁶.

In terms of company law, capital is one of the five basic contractual elements required for the existence of a company¹⁷. Capital has a different importance in the law of joint stock companies, which is a pure capital company. In a joint stock company, the capital is the value expressed in cash,

13 Özer p. 33 et seq. Although sustainability, corporate sustainability and corporate social responsibility are sometimes used interchangeably, we do not address the discussions on this axis within the scope of this study.

14 Corporate Social Responsibility, national public policies in the European Union, Compendium 2014, EU Commission, p. 9. <https://op.europa.eu/en/publication-detail/-/publication/2e198bc9-960e-4aab-a069-8ffeca53c7b7>

15 Okuyucu, p. 11; Demirel Özdemir, p. 544 et seq.; Pınar Özbatan Yağcı, Sürdürülebilirlik Perspektifinde Şirketlerin Sosyal Sorumluluğu ve Fransız Danıştayının Yetkisi, p. 23. For an indepth analysis of the concept and historical background see Okuyucu, s. 17 vd.

16 Özlem Akıncı Albayrak, Anonim Şirketler Hukukunda Şirket Malvarlığının Korunması, Onikilevha 2022, p. 14 et seq.

17 Poroy/Tekinalp/Çamoğlu, Ortaklıklar Hukuku I, N. 51; Mehmet Bahtiyar, Ortaklıklar Hukuku, Beta 2022, p. 19.

predetermined in the articles of association of the company, which is undertaken to be brought to the company by the shareholders¹⁸.

As a rule, as soon as a joint stock company is established, its capital represents the assets of the company. As long as the company continues its activities, the value of the assets of the company changes with the earnings, reserves, assets acquired by the company, but the capital of the company remains fixed as the amount shown in the company agreement, which can be changed by amendments to the company agreement within the framework of the rules stipulated by law.

Equity capital is a different concept from capital¹⁹, and may vary according to the company's activity. It refers to the difference between the total assets and total liabilities in the balance sheet (TPL²⁰ Art. 192). In this respect, equity capital includes the paid-in portion of the share capital, reserves, and unpaid profits left to the company²¹.

In Turkish Law, the mandatory minimum capital amounts for joint stock and limited liability companies are set forth in the law. In the doctrine, it is stated that this is a provision of the limited liability privilege of the company²².

In the taxonomy introduced in the Guideline, it is proposed that the portion of a company's equity capital provided by shareholders and the portion provided as a result of the company's activities should be presented separately. Accordingly, shareholders' equity capital (or shareholders' capital) is the continuously accumulated and publicly disclosed sum of transactions with shareholders, including contributions by shareholders to the company in exchange for shares as well as statutory capital and share premium (if any). This item also includes retained earnings available for

18 Albayrak, p. 14 et seq.

19 Celal Göle, Celal Göle, Anonim Ortaklıklarda Nakdi Sermaye Koyma Borcu ve Bu Borcu İfade Temerrüt, Ankara 1976, p. 7

20 Tax Procedure Law No. 213, Official Gazette No. 10703 dated 10.01.1961.

21 Mehmet Bahtiyar, Registered Capital System and Capital Increase in Joint Stock Companies, Istanbul 1996, p. 14; Göle, p. 7

22 In terms of terminology, see Albayrak, p. 41 et seq.; Poroy/Tekinalp/Çamoğlu, N. 467; Ali Paşlı, Anonim Ortaklık Kurumsal Yönetimi, Çağ Hukuk Vakfı, 2005, p. 217; Ali Murat Sevi, Anonim Ortaklıkta Sermayenin Oluşturulması ve Pay Sahiplerine İade Edilmesi Yasağı, Seçkin 2013, p. 73.

distribution to shareholders and may include certain legal reserves (when taken from shareholders' funds). Company equity capital, on the other hand, is the balance of accounting items on the liability side of the balance sheet, which includes all items other than liabilities and shareholders' equity as defined above. Company equity may include retained earnings and other non-distributable reserves, as well as certain statutory reserves (when taken from retained earnings and operating funds), including those defined under the recommendations in the Guideline²³.

2. The Principle of the Protection of Capital

The principle of protection of capital is one of the leading principles²⁴ governing the law of joint stock companies. It is also reflected in different articles of the Turkish Commercial Code (TCC)^{25, 26}.

The principle of protection of capital (or capital preservation) generally aims to prevent the company and shareholders from arbitrarily disposing of the capital brought in, thereby damaging the interests of creditors²⁷. This principle implies that the common purpose of the company is to generate profit and distribute it to its shareholders, but for the sustainability of the economic activities of the company, the capital of the company must be protected.

At this point, sustainability puts aside the classical tendencies towards shareholder protection and profit maximization and takes into account the interests of stakeholders other than the shareholder and the company, and even creditors, and calls into question "the economic purpose" of companies. With sustainability, it is stated that the purpose of companies is not only to generate income but also includes other objectives that concern other stakeholders of the company, the environment, and other public interests, including those of future generations²⁸.

23 Guideline pp. 27, 28.

24 Poroy/Tekinalp/Çamoğlu, Ortaklıklar I, N. 467.

25 Turkish Commercial Code No. 6102, Official Gazette dated 14.02.2011 and numbered 27846.

26 See TCC Art. 128, 343, 344, 345, 348, 349, 376, 378, 509, 512, 513.

27 Alihan Aydın, Anonim Ortaklığın Kendi Paylarını Edinmesi, Arıkan 2008, p. 9.

28 Guidio Ferrarini, Ed. Danny Busch/Guido Ferrarini / Seraina Grünewald: Sustainable Finance in Europe p. 85 et seq. On the direct relevance of these discussions to

This shift in perspective leads to a shift in views on how to dispose of - and therefore protect - company assets²⁹.

In the discussions in Turkish Law, *Okuyucu* stated that the managers should also consider the interests of the stakeholders in the decision-making process within the framework of corporate social responsibility, and in this sense, the aim of the company to make a profit should be softened³⁰.

Özer, who does not ignore the existence of the economic purpose of the company, accepts that at the point where the interests of the shareholders and social interests conflict, it would be right for the board of directors to implement plans that will increase the company's profit, but should not ignore the preferences that support the public interest while drawing up these plans³¹.

the theory of corporate law, see Fatma Beril Özcanlı, 'Sosyal Eşitsizliğin Giderilmesi ve İnsan Hakları Cephesinden Sürdürülebilir Bir Şirketler Hukuku', *Tüzel Kişilik Penceresinden Anonim Ortaklık Sempozyumu* ed. Seda Palanduz, F. Beril Özcanlı, Havva Karagöz, Onikilevha Yayıncılık 2021, pp. 177-198, s. 178.

29 In this regard, Ferrarini, for example, has critically analysed recent economic theories and policy perspectives that have either reformulated shareholder governance in a more radical way or sought to restore shareholder primacy in the broadest possible sense in relation to the purpose of the company, noting that he adopts the view of social value proponents who argue that companies should have ethical values, shareholder value enhancement proponents, as well as the enlightened shareholder view that can be said to lie in the middle of these two views; Ed. Danny Busco/Guido Ferrarini Seraina Grunewald Sustainable Finance in Europe, p. 85 et seq. Lambooy Argyrou Tideman has also pointed out that there is an inherent conflict between shareholder value maximization and stakeholder theories when corporate management proactively puts sustainability on the agenda and integrates it into strategic decision-making processes; Lambooy Argyrou Tideman, *Enabling Company Boards to Create Sustainable Companies* p. 22.

30 Enriques, on the other hand, after summarizing the part of Friedman's theory on why companies cannot be socially responsible, argues that this would not be valid today because the majority of publicly traded companies today include institutional investors and their effects should also be taken into account; Luca Enriques, *ESG and Shareholder Primacy: Why They Can Go Together*, *The Palgrave Handbook of ESG and Corporate Governance*, ed. Paulo Camara / Filipe Morais, Palgrave Macmillan 2022, pp. 131-136, s. 132.

31 Özer, p. 181. See also Yücel Dericiler, p. 101; Özbatan Yağcı, p. 99.

II. Comparison of the Recommendations of the European Law Institute Guideline With Turkish Law

The Guideline includes five key recommendations for companies to have sustainable equity capital under these five topics; sustainable basis for distributions, share premiums, minimum equity capital protection, legal reserves, and restriction on distributions (prudential approach). It is stated that the first of these recommendations provides a general framework for dividend distribution, recommendations 1 to 4 provide general purpose tools, and the EU and its Member States may consider introducing general prudential principles on the management of equity. The recommendations -and the principles that are pointed out in this respect- included in the Guideline are assessed under the headings below.

A. Dividend Distribution

1. Sustainable Distribution

While the Guidelines recommend a sustainable basis for distributions, it is suggested that distributions should be subject to a dual test in all cases. These tests are categorized as pre- and post-distribution tests, and it is recommended that there should be a sufficient amount of realized³² distributable retained earnings or net distributable accumulated reserves before the distribution, and that shareholders' equity capital³³ should be at least equal to the statutory paid-in capital and accumulated undistributable reserves after the distribution³⁴.

32 For the content of realized and unrealized gains referred to in the Guidance, see The Institute of Chartered Accountants in England and Wales, Guidance on Realised and Distributable Profits under the Companies Act 2006, 2017, Art. 3.9 et seq. <https://www.icas.com/regulation-technical-resources/documents/guidance-on-realised-and-distributable-profits-under-the-companies-act-2006>.

In terms of Turkish accounting system, see Turkish Financial Reporting Standards (15, 9) and Turkish Accounting Standards (40, 16, 21) published by POA, <https://kgk.gov.tr/DynamicContentDetail/5305/Tu%CC%88rkiye-Muhasebe-Standartlar%C4%B1-Tu%CC%88rkiye-Finansal-Raporlama-Standartlar%C4%B1-TMSTFRS>

33 Please refer to the explanations under C. I. above for the company equity capital and shareholders' equity capital in this respect.

34 Cem Veziroğlu, Kurumsal Sürdürülebilirlik için Şirket Sermayesi ve Finansal Muhasebe Hakkında ELI Rehberi'nin Türk Hukuku Bakımından Değerlendirilmesi, Aristo 2024, p. 18.

It was also recommended that a board policy on how to manage the company's equity should be determined and disclosed to the public, and recommended to use of the balance sheet test to protect financial capital³⁵.

The Guideline also recommend that the equity management policy should clarify how to achieve a sustainable balance between the interests of different and competing companies, shareholders, creditors and stakeholders, and obligations and ongoing commitments to social and environmental responsibilities; that the methods set out in the policy respond to societal expectations regarding corporate sustainability and related sustainable business behaviour; that realized and distributable profits be clearly disclosed in the company accounts; and that a financial impact assessment be conducted.

In any case, it is underlined that the dividend distributions to be made by the company should be limited to sufficient realized retained distributable profits and net retained distributable reserves, after setting aside undistributable reserves.

In general terms, the Guideline aims to clarify and extend the existing EU framework to more effectively address the specific needs arising from corporate sustainability, including corporate social and environmental responsibilities. In this context, the purpose and scope of non-distributable reserves are envisaged to be broadened to serve the continuity of the company and enable it to fulfill its social and environmental responsibilities over time. This expansion should also take into account that relevant stakeholders, including the company's shareholders, continue to receive a satisfactory remuneration.

These proposals appear to be essentially in line with Article 56 of EU Directive 2017/1132. This is also noted in the Guidelines³⁶.

When Turkish Law is examined, it is seen that the above-mentioned suggestions have a general equivalent in the existing regulations.

First of all, the principle of capital preservation, which is a fundamental principle in corporate law and which has been pointed out above, does not allow the distribution of dividends from the legally protected assets of the company in any way.

35 Guideline, p. 31; Veziroğlu, p. 18.

36 Guideline p. 31.

In addition, Article 509 of the TCC, after explicitly stipulating that no interest shall be paid on the capital, stipulates that dividends may only be distributed from net profit for the period and free reserves. This regulation meets the test required before distribution.

Article 519 of the TCC, on the other hand, meets the recommended post-distribution test both by stipulating that five percent of the annual profit shall be set aside as general legal reserves until it reaches twenty percent of the paid-in capital, and by explicitly stipulating that the general legal reserves may only be used to cover losses, to continue the business when business is not going well, or to take measures to prevent unemployment and mitigate its consequences, unless they exceed half of the share capital or issued capital. More precisely, according to the Guideline, shareholders' equity capital³⁷ consists of share capital and legal reserves, and agio. Under the recommended test, the shareholders' equity capital remaining after the distribution should be equal to the paid-in capital and accumulated legal reserves. Article 519 of the TCC does not require such equality between company equity capital, paid-in capital, and reserves; however, it also stipulates that a legal reserve fund must be set aside for the payments to be made to the shareholders. According to the Article, the mandatory allocation should be made until 20% of the paid-in capital is reached in terms of the first division of the legal reserve fund, and even if this limit is reached, the agios, if any, the price of the share certificates cancelled due to forfeiture and the amounts arising from the second division of the legal reserve fund should be added to this amount. In addition, this total amount may only be used for certain purposes, provided that it does not exceed half of the share capital or issued capital, as shown in the company's articles of association. These purposes also fall within the scope of the purposes referred to in corporate sustainability.

In addition to these, the Capital Markets Board's Corporate Governance Principles³⁸ and the Sustainability Principles Compliance Framework also stipulate that stakeholders' benefits should be observed as a company

37 Please refer to the explanations under C. I. above for the concepts of company equity capital and shareholders' equity capital.

38 II.17.1 Corporate Governance Communiqué, Official Gazette dated 03.12.2014 and numbered 288871

policy, and that the necessary arrangements should be made and disclosed to the public in the company's managerial strategy documents in this sense.

Accounting standards published by the Public Oversight Authority also draw particular attention to the concept of capital preservation³⁹. The Turkish Sustainability Reporting Standards,⁴⁰ prepared by the POA, also set out the general framework for the disclosure of sustainability-related risks.

2. Distribution Restrictions

In the Guideline, the limitation on profit that can be distributed in regulated sectors such as banking and insurance in EU Law, in line with the precautionary principle⁴¹ and the promotion of sustainable business behaviour, the principle of limiting the dangers to stakeholders and society could be extended to companies other than financial companies in order to ensure corporate sustainability, including corporate social and environmental responsibilities.

The recommendation in the Guideline is categorized as a precautionary approach. In this context, it is stated that if the reserves are below a certain threshold, restrictions may be imposed on distributions to shareholders or the maximum amount of annual distributions may be determined by law or by the general assembly upon the proposal of the board of directors, and this amount may be lower than the total maximum amount permitted to be distributed in accordance with the applicable corporate law regulations, thus establishing a continuous general reserve allocation mechanism.

Under Turkish law, the link between reserves and shareholders' dividends, in addition to the aforementioned mechanism of setting aside perpetual reserves, also helps to ensure the balance of interests that are intended to be protected in corporate sustainability.

Indeed, when the systematic of Articles 519 and 523 of the TCC is examined, in the event that the company makes a profit, the first allocation of the legal reserve fund is left to the company compulsorily, and the

39 In the standards, capital protection is evaluated under two headings: nominal protection and protection of productive capacity.

40 See footnote 33 above.

41 The Guideline state that prudence serves the purpose of maintaining the company's existence regardless of time and circumstances; Guideline p. 17.

shareholder interest is protected immediately, against that allocation which protects company's interest, with a basic dividend right⁴². In the event of a net profit for the fiscal period, Art. 519/2(c) of the TCC, together with Art. 507/1, Art. 509/2, and Art. 511 stipulate the payment of a basic dividend at the rate of five percent of the paid-in capital⁴³.

If, after these allocations from the net profit for the fiscal period, a share of the profit is still to be given to someone, the second allocation of the legal reserve fund is envisaged by balancing the interests of third parties with the interests of the company, and it is accepted that ten percent of the amount distributed to the beneficiaries outside the company will be added to the legal reserve fund.

Furthermore, Article 523 of the TCC obliges the company to set aside legal and voluntary reserves for the determination of the second dividend. The discretionary reserves herein may not only be for the benefit of the company, but also for the benefit of third parties such as employees or charitable organizations. The article also stipulates that the general assembly may decide to set aside reserves other than those stipulated in the law and the articles of association, if it is necessary for the restoration of assets or if it is justified for the continuous development of the company and the distribution of dividends as stable as possible, taking into account the interests of all shareholders. Even if there is no provision in the articles of association, the general assembly may set aside reserves from the balance sheet profit for the establishment or maintenance of charity funds and other charitable organizations for the employees of the company or for other charitable and charitable purposes. Therefore, the necessary measures in terms of corporate sustainability and even corporate social responsibility, as mentioned in the Guideline, have been taken under the TCC.

42 Zehra Badak, Shareholder's Right to Profit Share in Joint Stock Company According to the Turkish Commercial Code, Onikilevha 2018, p. 82.

43 Discussions on the contrary, see Aslı E. Gürbüz Usluel, Banka ve Ticaret Hukuku Araştırma Enstitüsü, 2016, p. 96 et seq.; Kerem Çelikboya, Anonim Şirketlerde Pay Sahibinin Kar Payı Hakkı, Onikilevha 2021, p. 72 et seq. The scholars referring dividend right as a non-mandatory right stipulate that the five percent dividend right mentioned under the law is intended as a prerequisite for the distribution of profit share to the members of the board of directors.

B. Share Premium

The Guidance states that share premium⁴⁴ and related reserves should be treated as regulatory capital and subject to the same rules, including restrictions on distributions and capital reductions, noting that the recommendation is in line with provisions 56 and 63 of EU Directive 2017/1132.

The premium, i.e., *agio*, has also been the subject of discussion in terms of Turkish Law at this point⁴⁵. This is because the inclusion of the addition to the reserve fund in Article 519 does not clarify whether the share premium is a capital element in the face of the regulation under Article 480 of the TCC. Therefore, while some authors are of the opinion that *agio* cannot be taken into account in terms of the prohibition of return of capital, some other authors have accepted that they are included in the prohibition of return of capital⁴⁶.

On the other hand, Article 519/2(a) of the TCC stipulates that, in any case, the portion of the premium provided for the issuance of new shares that has not been used for issuance expenses, redemption provisions, and charitable payments shall be added to the legal reserves. The Law also contributes to the social benefit aspect of sustainability by reserving the unused portion for charitable purposes.

C. Protection of Equity Capital

The Guideline note that in a number of EU countries there is a symbolic basis, making capital preservation regulations ineffective for the

44 Share premium -or *agio*- is positive difference between the par value and the selling price in case the partnership shares are sold at a value higher than the par value during the issuance; Güzin Üçışık, Aydın Çelik, Anonim Ortaklıkta Finansal Tablolar, Yedek Akçeler ve Kar Dağıtımı, Onikilevha, 2018, p. 234.

45 Poroy/Tekinalp/Çamoğlu, Ortaklıklar II, N. 1525; Şükrü Yıldız, “Anonim Ortaklıkta İhraç Primleri (*Agio*)”, Makalelerim 1988-2007, Yetkin Yayınları, Ankara, 2008, pp. 137-154, p. 137; Veziroğlu, p. 19.

46 İsmail Kırca, Anonim Şirketlerde Sermayenin İadesi Yasağı (TTK 405/II) ile İlgili Bir İnceleme (11. HD’nin 10.06.2008 Tarih ve E. 2007/12661, K. 2008/7660 Sayılı Kararının Değerlendirilmesi, Halûk Konuralp Anısına Armağan, C. III, Ankara 2009, pp. 641-660, p. 647; Yıldız, p. 140; Sevi, p. 434; Üçışık, Çelik, p. 233 et seq. It is stated that although some scholars accept premium is a type of profit, such profit cannot be distributed as dividend as a result of the restrictions under Art 519/3; Üçışık/Çelik, p. 234.

purposes of creditor protection and corporate sustainability; however, in the interests of sustainable business behaviour, some reserves should be established and maintained to safeguard the company's ability to continue its economic transactions, notwithstanding the minimum statutory capital requirement. In this regard, the Guideline recommends that shareholders' equity capital should include, but not be limited to, statutory paid-in capital and statutory reserves, all reserves necessary to facilitate corporate sustainability, including those required to fulfil social and environmental responsibilities, and all reserves that are defined as non-distributable under the recommendations.

The Guideline also suggests that positive net earnings (profit), if any, may be allocated between discretionary reserves that safeguard corporate sustainability, including social and environmental responsibilities, and payments to shareholders, strengthening the regime in Articles 75 and 76 of EU Directive 2017/1132 regarding what is and is not a dividend distribution as well as payments to shareholders, while noting that the accounting for profit advances should be deducted from available distributable profit.

The Guideline also states that in the event of a loss, reserves should not be used to cover the loss, and in this sense, the obligation to protect equity should be extended to include reserves necessary to ensure corporate sustainability, including social and environmental responsibilities⁴⁷.

The most important issue for the protection of equity capital under Turkish law is that the law still stipulates a meaningful minimum capital for capital companies. Pursuant to Article 332 of the TCC, joint stock companies must have a minimum capital of TRY 250,000 in the authorized capital system, TRY 500,000 in the registered capital system, and a minimum capital of TRY 50,000 is accepted in limited liability companies (Art. 580). In addition to this minimum amount, in joint stock companies, at least one-fourth of the company capital, which is guaranteed in cash, must be paid before the registration of the company. Furthermore, the remaining three-fourths amount should be completed within 24 months after the registration of the company (Art. 344). Moreover, if the shareholders are guaranteed to provide any capital-in-kind, the transfer of the property rights and

47 On this issue, see below Conclusion.

rights to claim is regulated specifically under law (i.e., Art 128, 339/2(e), 356) to provide such capital elements as a whole at the commencement of the company to protect the capital maintenance.

In addition, as stated above, even if there is no provision in the articles of association, the general assembly may allocate reserves from the balance sheet profit for the purpose of establishing or maintaining charity funds and other charitable organizations for the company's employees or for other charitable purposes, as set forth in paragraph 3 of Article 523 of the TCC. In addition, Article 522 stipulates that the articles of association may also allocate reserves for the purpose of establishing or maintaining charitable organizations for the company's directors, employees, and workers or to be given to public legal entities for this purpose.

Another important regulation regarding the protection of shareholders' equity capital is set forth in Article 520 of the TCC. According to this article, the company shall set aside reserves for its own shares acquired by the company and revaluation funds in an amount equal to their acquisition value, and these reserves may be set aside in an amount equal to their acquisition value only if the shares are transferred or destroyed. Revaluation funds and other funds included in liabilities pursuant to the relevant legislation may be dissolved if they are converted into capital and the revalued assets are amortized or transferred. All these regulations are included in the law in order to ensure sustainability, as indicated in the Guideline.

D. Allocation and Utilization of Legal Reserves

The Guideline defines the legal reserve as a precautionary measure that is protected from being distributed to shareholders through capitalization, and that the scope of such a protective measure should be expanded to better meet social and environmental responsibilities.

Accordingly, the Guideline recommends that legal reserve requirements should be based on total shareholders' equity capital, including agio, and that the minimum annual allocation of net earnings to this legal reserve should be set by law or by the general meeting of shareholders on the proposal of the board of directors. It further recommended that minimum legal reserve requirements should be based on total shareholders' equity

capital and not only on statutory capital, and that, where a minimum level of legal reserve is required, it should be based at least on statutory capital plus premium, and should be set by law or by resolution of the general meeting of shareholders upon the proposal of the board of directors.

The legal and discretionary reserve fund and profit distribution systems adopted in the TCC are in this direction. As it has been repeatedly stated above, after the first allocation of the legal reserve fund, premiums, if any, and the proceeds from the sale of the company's own shares obtained as a result of the strike-off shall be added to the legal reserve fund without any upper limit. Furthermore, if there is any distribution from the net profit other than the basic dividend right of the shareholders (i.e. the second dividend distribution to the shareholders or a profit distribution to the managers or the dividend distribution to the owners of the participation shares) 10% of the amount to be distributed must also be added to the legal reserves without any upper limit (Art. 519/2). In addition to the legal reserves mentioned in the Guidelines, it is also possible to set aside discretionary reserves upon the proposal of the board of directors and the resolution of the general assembly. Indeed, Articles 521 and 523 of the TCC allow for such reserve fund allocations, either by inclusion in the articles of association or by resolution of the general assembly.

Conclusion

The Guidelines published by the European Law Institute are important in terms of drawing attention to the importance of equity in ensuring corporate sustainability and providing guidance to companies in this sense.

In addition, considering the five different recommendations in the Guideline, it can be concluded that the regulations introduced in the TCC are generally capable of meeting the requirements of corporate social responsibility desired by the Guideline. More precisely, when the recommendations in the Guideline are compared with the Turkish Law, it is concluded that companies are provided with sufficient opportunities in terms of corporate sustainability in the provision, protection and utilization of equity capital, the Legislature observes the balance of interests and provides tools to protect the interests of all participants for companies that wish to further expand their corporate social responsibility practices.

At this point, of course, there are some differences between the systematic of the TCC and the system proposed by the Guidelines. However, these differences generally stem from the difference between the economic purpose of capital companies and the interests that companies should protect within the framework of corporate social responsibility.

Indeed, for example, setting a mandatory upper limit for the company's profit to be distributed, as envisaged in the Guidelines, would be incompatible with the purpose of the establishment of capital companies in general. This is because capital companies are the purest manifestation of economic purpose. Here, it is up to the legislator to ensure the balance of interests. In this respect, the TCC already accomplishes this with the systematic of reserves and dividends that we have tried to explain above.

Similarly, the reserve fund distinctions set out in the Guidelines will both impose a separate financial burden on companies and restrict the dividend expectations of shareholders. In other words, the introduction of mandatory segregation of reserves in all companies to meet social obligations in addition to the existing ones in order to protect equity will affect the economic balance between companies and will also limit the profits of shareholders. *Veziroğlu* also drew attention to this situation and rightly stated that it is a daring intervention into the reserve funds⁴⁸.

48 *Veziroğlu*, p. 20.

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