

TAX LIABILITIES OF BOARD MEMBERS AND MANAGERS IN A JOINT STOCK COMPANY

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A joint stock company (*anonim şirket* or “AS”) is a company defined under the Turkish Commercial Code and the liability for obligations of AS shareholders is limited to each shareholder’s capital participation.

An AS is managed by a board of directors and by managers appointed by the shareholders or by the board. Neither the directors nor the managers are required to be Turkish citizens or residents of Turkey. In general, directors and managers of an AS are not personally liable for agreements and transactions executed on behalf of the company unless they have acted negligently or intentionally. A significant exception to the liabilities of directors or managers is found in the tax legislation. In principle, an AS as a legal entity is subject to the legal consequences that may be applicable as a result of a failure in the performance of a tax liability. However, as an exception to this principle, the legal representatives of an AS may be held personally liable under certain conditions. Pursuant to the amendment dated 3 December 1988 to the Tax Procedural Law, regardless of the existence of a fault or negligence on the part of the directors or officers in the failure of a performance in tax liabilities and which failure is the cause for collection proceedings, directors or managers can be held liable for non-performed tax liabilities upon the occurrence of certain conditions.

The personal liabilities of directors and managers with respect to the tax debts of a company can be analyzed under the following headings:

Tax Legislation and its Scope.

Article 10 of Tax Procedural Law No. 213 (“Tax Procedural Law”)¹ governs the collection of tax payments from the legal representatives of an AS in the event tax payments cannot be collected from the company.

The collection of public debts from the legal representatives of an AS, in the event such public debts cannot be collected from the company, is governed by Additional Article 35 of Law No. 6183 Concerning Collection of Public Debts (“Law No. 6183”)². The public debts referred to in Additional Article 35 do not actually cover tax receivables. The purpose of this Article is to ensure the collection of public debts other than tax payments to be collected under Article 10 of the Tax Procedural Law.

The liabilities granted to legal representatives under Additional Article 35 are broader than Article 10 of the Tax Procedural Law. Pursuant to this Article, legal representatives are liable for public debts which cannot be collected from the assets of the company and in cases where the tax authority is convinced that such debts are not likely to be collected from the company. However, pursuant to Article 10 of the Tax Procedural Law, as confirmed by

¹ Published in Official Gazette No. 10703 dated 10 June 1961.

² Published in Official Gazette No. 8469 dated 28 July 1953.

certain decisions of the Council of State (“Danistay”)³, a payment order can be notified to the legal representative only when the tax administration fails to collect its receivables from the assets of the company due to the company’s insolvency. Unlike Additional Article 35, Article 10 of the Tax Procedural Law does not provide for the discretion of the tax administration.

We believe that the collection of the tax receivables of an AS from its legal representatives should be made under the Tax Procedural Law. Additional Article 35 of Law No. 6183 should apply only when the tax debt of a company becomes final (i.e., upon the expiration of the 30-day period to file a lawsuit or finalization of the lawsuit if a lawsuit has been filed). Danistay, in its certain decisions⁴, confirmed this conclusion. However, in practice, tax offices may send payment orders to legal representatives under Additional Article 35 without any need to finalize proceedings regarding insolvency of a company.

Who are Considered Legal Representatives under the Tax Legislation?

General Communiqué No. 390⁵ issued by the Ministry of Finance aims to define the legal representatives of an AS. Pursuant to this Communiqué, the legal representatives of an AS are:

- (i) each director with the power to manage and represent the company; and/or
- (ii) each appointed manager with the power to manage and represent the company.

Danistay, in its Decision No. E. 1998/2761, K. 1999/2128, confirmed that a director is considered a legal representative as defined under the tax legislation only if such director is granted authorization to represent the company. The authorization to manage and represent a company (i.e., authority to sign on behalf of the company) is granted either in the articles of association of the company or by a further decision of the board of directors or general assembly. Such decision regarding representation must be registered with the Turkish Trade Registry.

Accordingly, the legal representatives who may be held liable for the tax debts of a company are the directors and/or managers whose authorization to represent the company is registered with the Trade Registry and whose authorization is published in the Turkish Trade Registry Gazette. The liable legal representatives shall be determined solely by the tax office in accordance with the records at the Trade Registry. A legal representative shall be released from any liability which arises after his resignation, provided that his resignation is registered with the Trade Registry and such resignation is published in the Trade Registry Gazette. Although it is not the position in law, in practice the tax office may also pursue a legal representative who has already resigned if the tax obligation of the company had arisen during the term in which he was such legal representative.

Personal Liabilities of Directors and Managers.

Before the amendment in 1988, Article 10 of the Tax Procedural Law provided that legal representatives shall be held personally liable for tax payments if they fail to perform

³ Tax Chambers General Assembly Decision No. E. 1999/153 K. 1999/507; Seventh Chamber Decision No. E. 2000/2724 K. 2000/3446.

⁴ Danistay Third Chamber Decision No. E.1996/6514, K. 1998/1701; Danistay Seventh Chamber Decision No. E. 1997/5295, K. 1998/4660 and Danistay Fourth Chamber Decision No. E. 1997/1869, K. 1997/3971.

⁵ Published in Official Gazette No. 22526 dated 17 January 1996.

their duties due to their fault or negligence. The amendment deleted the words “*due to their fault or negligence*” and the liabilities of legal representatives thus became objective. In other words, legal representatives will be personally liable for the tax liabilities of a company, regardless of their fault or negligence, in the event any of the below shall occur:

- (i) initiation of collection proceedings against the company for a tax payment obligation (tax, default interest or tax penalty) arising from the failure of performance of tax liabilities in a timely and proper manner;
- (ii) as a result of the collection proceedings in (i) above, failure of the tax administration to collect its tax receivables due to the insufficient assets of a company after the collection process by the tax authorities; or
- (iii) a tax obligation of the company becomes due as a result of the failure of the legal representative to perform his duties with respect to the payment of taxes.

The failure of a legal representative to perform his tax duties (i.e., occurrence of a tax payment obligation) is automatically deemed as the legal representative’s fault and/or negligence. Accordingly, regardless of the existence of a fault or negligence on the part of the legal representative in the failure of performance of tax liabilities and which failure is the cause for collection proceedings, a legal representative can be held liable for non-performed tax liabilities upon the occurrence of the conditions above. Legal representatives of a company are jointly and severally liable for their above-stated tax liabilities, however, if such failure of performance of tax liabilities of a company is due to an event of *force majeure* they will not be held liable.

Danistay, even after the amendment, interpreted Article 10 in the same manner and, in its various decisions, invalidated tax proceedings against legal representatives when the representatives had proved that they were not the legal representative during the period in which the tax liability had arisen and that they did not have any fault or negligence in the tax debts of the company. In conclusion, legal representatives shall be held personally liable for the tax debts of a company until such time that they can prove they were not in default.

What Happens in Practice?

In practice, tax offices, without finalizing the tax proceedings against a company, send separate payment orders to the legal representatives and hold them personally liable for the tax debts of such company. Danistay Third Chamber Decision No. E. 1991/1129, K. 1992/1170 provides that the tax obligation notified to the company becomes final and it is not necessary to send a separate notification to the legal representatives. However, in practice, tax authorities send a separate payment order to each legal representative under General Communiqué No. 387⁶.

Pursuant to the provisions of Law No. 6183, the highest ranking officer in the public administration may impose a cautionary attachment (*ihiyati haciz*) on the assets of the legal representatives of a company without any need for notification of a payment order.

⁶ Published in Official Gazette No. 22330 dated 1 July 1995.

In certain cases, the legal representatives of a company may be prohibited from departing Turkey pursuant to Passport Law No. 5682⁷. However, pursuant to General Communiqué No. 395⁸ issued by the Ministry of Finance, such prohibition on the legal representative can be revoked at the discretion of the Ministry of Finance and without any need for a security deposit, under the following conditions:

- (i) the legal representative is in good faith in payment of the tax;
- (ii) the prohibition on the legal representative adversely affects the legal representative's ability to pay the tax; and
- (iii) the legal representative's departure does not adversely affect collection of the public debt.

It should be noted that in the event the payment order is notified to more than one legal representative, the prohibition to depart the country may be imposed on just one legal representative and may be revoked for the others.

What Remedies are Available to Directors and Managers?

If the company fails to make the necessary tax payment, the tax office shall collect the tax receivables from the directors and/or managers regardless of the existence of fault or negligence. The filing of a lawsuit by the company against the tax administration shall not prevent the tax office from notifying a payment order to the legal representatives of the company. The director and/or manager will then have the following options:

(i) pay the tax debt and then ask for recourse from the company for the amount paid by the legal representative. However, in such scenario, the legal representative will not be able to collect such amount from the company since the tax administration requests such amount from the director due to insufficient assets of the company; or

(ii) file a lawsuit (within 7 days starting from the notification of the payment order to the director) against the tax administration for the invalidation of the payment order with the claim that (a) the tax liability had not arisen during such director's term or due to such director's fault or negligence, and/or (b) the tax obligations must be collected pursuant to Article 10 of the Tax Procedural Law and such a payment order may not be notified until all remedies available to collect the tax debt from the assets of the company have been exhausted. An objection to a payment order does not suspend the payment obligation unless a security covering the entire debt has been deposited.

* * *

Conclusion

Although it is not the intention of the law, tax offices hold legal representatives personally liable and send them payment orders without seeing the need for finalizing proceedings against the company. However, such practice is not in compliance with the Tax Procedural Law since we believe that the tax office may not start any proceeding against a legal representative until its proceedings against the company become final. Further, a legal representative who has no fault or negligence in the performance of the tax debts of a

⁷ Published in Official Gazette No. 7564 dated 24 July 1950.

⁸ Published in Official Gazette No. 22663 dated 11 June 1996.

company should not be held liable. Danistay, in its many decisions, invalidated such illegal tax proceedings and also did not hold legal representatives personally liable when such legal representatives were able to prove that they were not in default. ⊕

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