

“Legal Entity Members of the Board of Directors” and “Legal Entity Managers” in the Context of Tax Liability for Legal Representatives

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The tax liability of corporations' legal representatives is an issue that frequently causes dispute in the field of tax law. This topic is also within the fields of interest and impact of Turkish Commercial Code and commercial law due to its relation to corporations' law.

Through the Turkish Commercial Code numbered 6102 [new] ("**TCC**"), which entered into force on July 1, 2012, many different regulations have been introduced compared to the former Turkish Commercial Code numbered 6762 ("**FTCC**"), which was applied to many topics and institutions in the field of commercial law for more than 50 years.

In this respect, the TCC's regulations (Art. 369-396) with regard to the boards of directors of joint stock companies include certain different rules than the previous provisions of the FTCC (Art. 312-346). One of the changes introduced by the TCC is to allow legal entities to be directly appointed to the board of directors as members in their own names.

This study evaluates the tax law regarding the board member's capacity as a legal representative where a legal entity becomes a member of the board of directors. This study compares the TCC regulations and practice with those that were in force during the application of the FTCC. This study also evaluates the circumstances around managers in limited companies.

1. Tax Liability of Legal Representatives: Article 10 of the Tax Procedure Law No.213 ("TPL") and Article 35 (bis) of Law No.6183 on Procedure of the Collection of Public Receivables ("Law No.6183")

"Taxpayer is the real person or the legal entity, that is imposed tax duty according to the tax legislation." (TPL Art.8/1)

"The tax responsible is the party that is the addressee of the tax office with respect to the payment of the tax." (TPL Art.8/2)

A tax responsible will generally have a close legal and actual relationship with the tax payer. The tax responsible may be either a real person or legal entity, the same as for taxpayers.

There are various forms of liability in the Turkish tax system. The regulations related to these forms of liability are set forth in the TPL and certain other tax laws.

One form of liability, which is stipulated in Article 10 of the TPL with the heading "*duty of the legal representatives*", is the liability of the taxpayers' legal representatives:

"In case the taxpayers or tax responsables are legal entities, minors, restricted persons and institutions such as Foundations and congregations without a legal personality, the duties of these according to the law are fulfilled by their legal representatives, managers of the unincorporated entities or representatives of those if any. / In case of failure of the above-written representatives in fulfilling such obligations, tax and corresponding receivables that could not be collected in part or as a whole from the assets of taxpayers or responsables, are collected from the assets of those who have failed to fulfill the legal obligations. / This provision shall also apply to local representatives of taxpayers who are not resident in Turkey. / Legal representatives or the managers of the entity may take recourse against the actual taxpayers for the taxes paid in this manner...."

Another provision regulating the liability of legal representatives is Art. 35 (bis) of Law No.6183:

"The public receivables, of which it is clear that the collection is not possible as a whole or in part from the assets of the legal persons, minors and disabled persons, or institutions such as foundations and congregations without a legal personality, will be collected according to the provisions of this Code from the personal assets of the legal representatives and the managers of the institution without legal personality. / The provision of this article will also be applied to the representatives of the foreign persons and institutions in Turkey. / The fact that the legal persons have entered into liquidation or have been liquidated does not release the legal representatives of their responsibilities for the times prior to the date of entry into liquidation. / The representatives, the persons that manage the institutions or the representatives can take recourse against the real debtor of the public institutions for the amounts they have paid according to this article. / In case the legal representative or the manager of the institution on the accrual date of the public receivable is different than the persons when the public receivable became payable, they shall be jointly liable for the payment of the public receivable. / The provisions regarding the liabilities of the legal representatives set forth under the Tax Procedure Law No. 213 shall not remove the liability regulated in this article."

2. Prior to the [new] TCC, a legal entity was only able to be a "board member" through a real person representative, while a legal entity was entitled to directly be a manager of a limited company: Article 312 and 540 of fTCC

For commercial or business reasons, a company may choose to acquire shares of other companies and may also choose to get involved in the management of these subsidiary companies. It is worth evaluating the potential tax liability of the company's legal representatives in such cases.

2.1 Board Members that were Appointed to Represent a Legal Entity During the Term of fTCC

It was not possible for legal entity shareholders to directly be board members in joint stock companies, as per the provision of Article 312 of fTCC numbered 6762 which regulated membership of the board of directors (unlike Article 359 of TCC):

"A legal entity that is a shareholder cannot be a director. Real persons representing the legal entity may, however, be elected as member of the board of directors." (3rd and 4th sentences of Article 312/2 of fTCC)

As is seen, under the fTCC it was not possible for a legal entity shareholder to directly become a member of the board of directors itself. Rather, real persons determined by the shareholders of the legal entity were placed in the boards of directors. During this period, the discussion point of tax-related liability was "as to whether the liability arising from the position of the real person, who is the legal representative of the

company being participated in, affect the company being represented by means of tax-related liability or not".

Two different approaches to this point appeared:

1. The real person who is elected as the board member of the company being participated in (subsidiary) to represent the participant company (parent company) shall be evaluated separately from the parent company once he/she became a board member of the subsidiary. Accordingly, in terms of the liability of legal representatives, the one to be deemed liable with regard to the tax-related debts of the subsidiary should be the real person board member and not the parent company.
2. The real person is on duty as a member of the subsidiary's board of directors in order to represent another legal entity (parent company). Therefore, the parent company, which has assigned the real person as the member of the board of directors, may be held directly liable for the consequences of such duty and title. In other words, the parent company should be liable for the tax debts incurred by the legal representative within the scope of the subsidiary.

The Council of State's usual decisions during that period (even if there were counter-decisions) were in line with the first approach, both in terms of the application of Article 10 of the TPL and Article (bis) 35 of Law No.6183.

The above conclusion would not change even if the member of the board of directors, who is elected to represent the participant company, is also the participant company's legal representative. In other words, it was not possible to extend liability from the legal representative to the participant (parent) company for tax debts incurred by the legal representative within the scope of the company being participated in (subsidiary).

2.2 A Legal Entity being the Manager of a Limited Company under the provisions of the fTCC

Despite the common perception, under the fTCC it was possible to appoint both real person or legal entity managers. Contrary to Article 312/2 of the fTCC, Article 540/4 of the same enabled such an assignment. Accordingly, when the fTCC was in force, while a legal entity shareholder could become manager of a limited company, it could not become a member of the board of directors of a joint stock company.

It is noteworthy that we have not found any discussion (either as a contention of doctrine or as the subject matter of a legal proceeding) regarding the scope of tax-related liability of a legal entity acting as a legal representative that was directly appointed as manager in its own name. Since no amendments have been made to the TCC compared to the fTCC in relation to the tax-related liability of legal entities that are directly appointed as managers of limited companies, this will not be evaluated under this section. Rather, this is discussed in the topics numbered (4) and (5) below.

3. New Order within the Scope of the Regulations Provided Under Article 359 and 623 of the TCC

3.1. The concept of a Legal Entity Member of the Board of Directors

As stated above, one of the changes introduced with the new regulations is to enable legal entities to be appointed as members of the board of directors.

In such cases, the real person who the legal entity (which is a shareholder of the company) appoints as the member of the board of directors must be registered with the trade registry by the subsidiary company along with information about the real person and the legal entity announced in the trade registry gazette. The

registration and announcement must also be stated on the subsidiary company's website. Only this real person will have the right to attend the board meetings and vote in the name and on behalf of the legal entity. In this regard, the registration has a constitutive effect as it establishes and makes explicit the participant legal entity's membership on the board and the identity of the real person representing the legal entity. The announcement, on the other hand, is made in order to notify third parties. The preamble of the Article 359 of TCC specifies that identification and registration of the real person representative are brought for the purpose of preventing a legal entity board member from sending different persons to each and every board meeting in order to destabilize the board's operation.

The legal entity shall determine the real person representative, not the general assembly. Therefore no clause shall be inserted into the Articles of Association in this respect. This is because it is the legal entity that has been appointed as the member of the board of directors and not the real person himself. Where the legal entity wants to change the real person attending the board meetings in its name the legal entity should notify the subsidiary company about the change so that the subsidiary company can arrange to register and announce the new representative's appointment. The right to determine and change the real person representative belongs to the legal entity board member.

The preamble of the Article 359 states that; (i) by holding the legal entity liable as the member of the board of directors, it aims to give assurance to the company, shareholders and the creditors, (ii) where group companies exist, it is necessary to accept the system of Article 359 as a law (iii) by adopting this rule, the former practice under which a legal entity could have more than one representative and voting right in board is replaced. This practice was against the balance of interests and therefore contrary to the dogma and the theory of the fTCC. This rule amends the structure to grant a legal entity board member one voting right, just like every other board member.

The Preamble further states that, by allowing legal entities to directly become board members in joint stock companies, the TCC removes the principle that legal entities cannot be held liable for the acts and transactions of their representatives on the board. Thus the TCC adopts the concept of the legal entity being directly liable as the board member. It further states that the era of ignoring legal realities by having board members without any assets thereto has also come to an end.

3.2 The Ongoing Concept of Legal Entity Manager

On the other hand, with regard to the managers of limited companies, 623/2 of the TCC accepts that legal entities may be elected as the managers of limited companies in line with Article 540/4 of the fTCC. In such cases it is necessary for the legal entity to assign a real person to fulfill the manager's duty.

4. The Position of Legal Entities as Members of the Board of Directors and as Managers, within the Context of the Tax-Related Liability of Legal Representatives

With the rearrangement of the TCC, the real person representative of a legal entity board member should not have any liability.

This is because:

1. Although previously it was possible to evaluate such a real person separately to the legal entity that "proposed" him/her as the board member, now it is unlikely that the real person can be evaluated separately from the legal entity that is "appointing" him/her as its representative.

2. Although previously the real person's resignation from the board was required, now the legal entity (as the party appointing such a real person) may replace such a person without requiring his/her resignation from the board membership.
3. This real person is, in fact, acting like a "puppet", voting/signing on behalf of the legal entity, which is actually the manager or board member.

These conclusions and remarks briefly summarized above can also be found in the preamble of the TCC.

These conclusions and remarks also apply to other tax-related liability besides liability for the tax debt.

Although previous Council of State precedents determined real person board members to be liable for the tax-related debts of subsidiaries, and not the parent companies, it seems that the new era will bring a contrary conclusion. The Council of State's previous decisions were based on the applicable regulations of the fTCC and its commercial law related interpretation.

5. The Status of a Legal Entity's Legal Representative which is Directly a Member of the Board of Directors or a Manager of its Subsidiary, in relation to the Tax Liabilities of the Subsidiary

We have reached the conclusion that a legal entity shareholder who is a board member or manager of its subsidiary in its own name, is liable for the tax-related debts of its subsidiary due to the legal entity shareholder's status as a legal representative.

At this point, another question that may spring to mind is: Are the participant company's own representatives (board members/managers) also liable for the tax-related debts (or public debts), which the participant company is liable for, based on their titles as legal representative?

In order to answer this question, the content of the tax debts (public debts) that are in the scope of the legal representatives' liability must be determined. Therefore, it is also possible to ask the questions in this way: Are the legal representatives of a company liable for the tax debts (or public debts) that the company is liable for, in addition to the tax debts (or public debts), that such company is legally obligated to pay?

We are of the view that the answers of these questions should be evaluated severally as per Article 10 of TPL and Article 35 (bis) of Law No.6183:

Article (bis) 35 of Law No.6183 outlines liability for public debts. The scope of "public debts" is specified under Articles 1 and 2 of Law No.6183.

The execution and collection procedures, which have been regulated by Law No.6183, shall be applied against the public debtors. What should be understood by "public debtor" is stated under Article 3 of the Law No.6183 as *"Public Debtor or debtor term: means the legal representatives or heirs, taxpayers, tax responsables, sureties and representatives of foreign persons and entities (...) of those real persons and legal entities that are obliged to pay the public debt."*

Upon making these determinations we may reach a conclusion that within the scope of legal representation based on direct board membership, in the event that the participant company is liable, it is possible to extend the proceedings initiated under the Law No.6183 to include the participant shareholder's own legal representatives (board members/managers). This is because a public debt will, in any case, have such quality even if it belongs to the subsidiary. Furthermore, it is quite clear that based on its title as "legal representative", a legal entity which is directly a member of the board of directors is the "legal entity that is obliged to pay the

public debt" of the subsidiary. Further, the legal representative of such a participant company (i.e. legal entity board member/manager) will be deemed as "public debtor" in accordance with Article 3 of Law No.6183.

It does not seem possible to reach the same conclusion in terms of the liability regulated under Article 10 of the TPL. Such liability is not triggered automatically with non-collection and without being subject to any condition, unlike the provision regulated in Article (bis) 35 of the Law No.6183. In order to initiate legal proceedings against a legal representative under Article 10 of the TPL, "the non-collection of tax debts from the actual debtor is required to arise from breach of tax liabilities". In this case, it seems unacceptable to proceed against the legal representative (board member/manager) of a parent company due to the tax debts or tax-related duties of its subsidiary in accordance with Article 10 of the TPL. This is because it is not a parent company's duty to fulfill those obligations and, even if it wishes to fulfill them, it is not legally possible. The accuracy of this conclusion will make clearer sense in the case of an indirect shareholding.

Accordingly, although under Article 10 of the TPL the participant company's representatives are not liable for the tax-related debts (or public debts) which the participant company is liable, they shall be liable for these debts in accordance with Article (bis) 35 of Law No.6183.

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