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COUNCIL OF STATE RULES ON THE LIABILITY REGIME REGARDING THE PUBLIC DEBTS OF LLCs

A limited liability company's ("LLC") liability for its debts and obligations, unless it is expressly stated in its articles of association, is limited with its assets¹. In other words, in LLCs the liability arising from debts and obligations belongs to the legal entity itself. However, there is an important exception to this general rule. The director of an LLC who manages and represents the company before third parties and the shareholders are personally liable for public debts of the company, unless these debts are duly paid by the company.

The shareholders or the director will be liable for the public debt of an LLC in case of following situations:

- Where the value of the seized assets do not meet the public debts and taxes, or if the company is insolvent,
- If the assets of the company are not seizable,
- If the company is bankrupt and the public debts cannot be collected from company's estate

Even if a shareholder transfers its whole shares to a third party, it remains jointly liable with the transferee for the public debts arising before the transfer. If the shareholders are different persons when the public debt arose and when it is payable, they shall be jointly liable.

There was a controversial discrepancy between the decisions of the Tax Law Chambers and 9th Chamber of the Council of State regarding the order of priority between the director and the shareholders in terms of liability for unpaid public debt of LLC.

There were two opposing views of the chambers. First one proposes that if the LLC is unable to pay its public debts by its own assets, director will be liable in the first place. In other words, the liability of the director is prior to the shareholders.

According to proponents of this view, the director is liable for the entire public debts pursuant to Article 10 of Tax Procedure Law, while the shareholders are only liable for the public debts in proportion to their shares in the capital.

(1) For more information about LLC, please read our article from [here](#).

Second one proposes that there are different liability systems for the director and the shareholders, and it cannot be interpreted as existence of an order of priority between the director and the shareholders of LLC with regards to the unpaid public debt. Therefore, both the director and the shareholders will be responsible for unpaid public debts without order of priority.

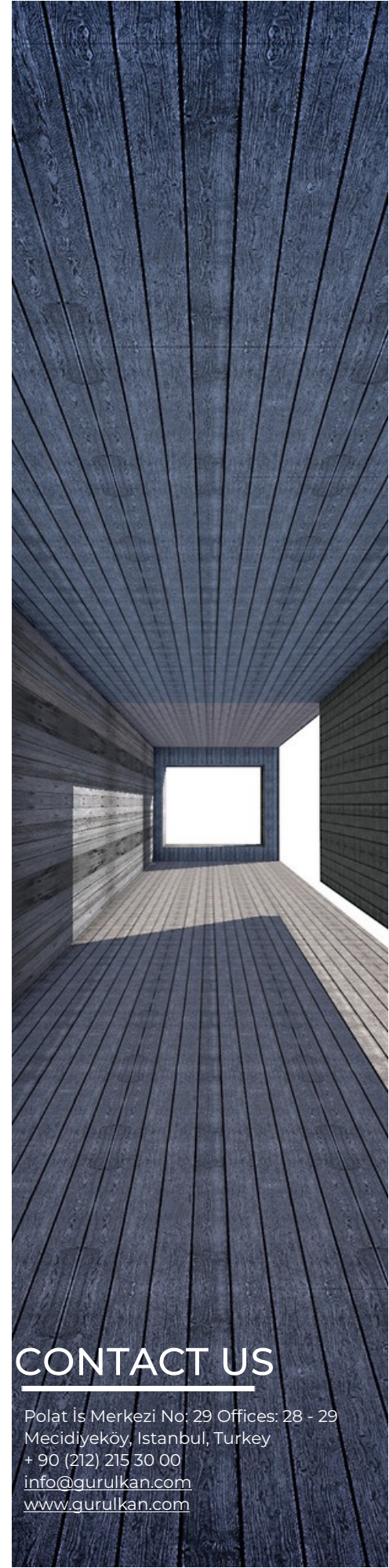
Board of the Unification of Case Laws of the Council of State has given a remarkable decision ("decision") which was published in the Official Gazette on June 20, 2019. The decision stated that the director and the shareholders of an LLC are personally and jointly liable for the unpaid public debt of the company, unless such debt is collected from the assets of the company. Hence, there is no order of priority between the director and the shareholders.

According to the decision², one of the most significant differences between an LLC and a Joint Stock Company³ ("JSC") is the liability regime regarding the public debts. In an LLC, the liability of the shareholders to third-party creditors is limited to the amount of share capital contributed to the company. Besides, they may be held personally liable for public debt such as taxes in proportion to their shareholding in the company. It is possible to define this situation as limited personal liability and it is also regarded as absolute liability. As such, this liability is not actually a tax liability but a liability for the collection of public debt.

On the other hand, the liability of director for public debt is based on fault. It is possible to escape from liability by proving that there is no fault at fulfilling the duties with regards to public debt.

It is also stated in the decision that the order of priority between the director and the shareholders for public debt are not stated explicitly in neither the Tax Procedure Law nor in the Law on Collection Procedure of Public Receivables. The reason for joint responsibility is the to ensure the rapid collection of the public receivables.

It is important to note that the recent decision given by the Council of State is significant both for the shareholders and the directors of LLC as well as foreign investors who prefer establishing an LLC rather than a JSC.



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(2) Merge Case Law Number 2013/1 – 2018/1.

(3) For more information about JSC, please read our article [here](#).