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Panel 1: Foundational audit principles and applicable taxpayer rights.

**Taxpayer Rights during Tax Audits:
Reasonableness in Time and Equality in Arms
DRAFT**

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1. Introduction

Tax audit authority of the tax administration is one of the most powerful tools to examine taxpayer's compliance. There is no doubt that the audit process, among others, is an interference with the taxpayer's right to privacy and confidentiality for the public good. However, in order to establish the balance between public benefits and the individual rights, the taxpayers are required to be armed with balancing rights during the audit processes. The legitimacy of the audit examination depends on the proportionality of the administrative powers to be used and rights to be granted. Thus the power of the state must be limited by balancing rights.

Tax audit is a process conducted by competent authorities to examine and determine the accuracy of the taxes paid and maintain the correctness of the taxes.¹ To that end, tax audits contain an analysis of the tax returns, books, accounts and etc. of the taxpayer. The tax auditors that are authorized to access to all the relevant information about the taxable

¹ Article 134 of the Tax Procedure Act (Official Gazette of 10 Jan. 1961).

person investigate the facts, collect evidence, question and listen to taxpayers and related witnesses and gather third party information. During the audit process, there is no doubt that the auditor is authorized to discover the criminal acts as well.² Thus, punitive actions, and evidence collection thereof, are also covered by the audit process.³

The tax audit proceedings which fall prior to the tax litigation are covered by the right to a fair trial⁴. Thus, taxpayers may enjoy many rights that are derived from that right such as right to be heard, right to equality of arms, right to adversarial proceedings, right to impartiality, right to a reasonable time and right to defense etc. This interpretation can be based on the outcome where the European Court of Human Rights (ECrthR) reached on article 6 § 1 in *JB v. Switzerland* case.⁵ As it is well-known, article 6 § 1 of the European Convention on Human Rights provides insofar as relevant: "*In the determination of his civil rights and obligations or of any criminal charge against him, everyone is entitled to a fair ... hearing ...*". Furthermore, fair trial rights are not applicable in pure tax cases as a result of the jurisprudence of the ECrthR given in the *Ferrazzini* case.⁶ The ECrthR, however, considers the tax penalties as criminal

² Article 364 of the Tax Procedure Act.

³ B.Yalti, *Vergi Yukumlusunun Haklari*, Beta, Ist. 2007 at 112-113.

⁴ Cf. G. Maisto, "*The Impact of the European Convention on Human Rights on Tax Procedures and Sanctions with Special Reference to Tax Treaties and the EU Arbitration Convention*", in G.Kofler et al. (eds.), *Human Rights and Taxation in Europe and the World* (IBFD, 2010), at 376. Cf. P. Baker, P.Pistone, *The Practical Protection of Taxpayers' Fundamental Rights General Report*, IFA Cahiers, vol.100B, IBFD, The Netherlands, 2015, at 36.

⁵ ECrthR, Second Section, *J.B. v. Switzerland*, 3 May 2001 (3 Aug. 2001 final), Application no. 31827/96.

⁶ ECrthR, Grand Chamber, *Ferrazzini v. Italy*, 12 July 2001, Application no. 44759/98.

charges depending on certain conditions.⁷ In the JB case, the ECtHR came to the conclusion that whatever other purposes the proceedings served, by enabling the imposition of such a fine on the taxpayer, the proceedings amounted to the determination of a criminal charge within the meaning of article 6.⁸ Thus, during the tax audit proceedings that have the risk (possibility) of a tax penalty decision at the end of those proceedings, taxpayers may enjoy the right to a fair trial.⁹

As mentioned above, taxable persons may benefit from many rights during the tax audit proceedings from the very beginning till the end of those proceedings. For example, the audit decision about a certain taxpayer must be impartial, likewise based on risk analysis or denunciation or compliant of third parties or random or business sector basis; i.e. free of political concerns. Taxpayers must be informed about the reasoning and the scope of the audit at the very beginning of the audit so that certainty prevails till the end. Thus, the proceedings must be fair and proportional to the aim that is being sought by the tax administration.

Another issue which relates to certainty is that the audit proceedings must be completed within a reasonable time. The taxpayer must not be placed in an uncertain position. This principle is closely linked to proportionality principle¹⁰ and derives from fair trial rights which extend throughout the

⁷ See ECtHR, *Bendenoun v. France*, 26 Jan. 1994, Application no. 3/1993/398/476. ECtHR, Grand Chamber, *Jussila v. Finland*, 23 Nov. 2006, Application no. 73053/01.

⁸ ECtHR, *J.B. v. Switzerland*, para. 49. A similar result may be derived from the a *contratio* interpretation of the decision given in the *Hozee* case. *Hozee v. The Netherlands*, 22 May 1998, Application no.81/1997/865/1076. (See, B. Yalti, *Vergi Yukumlusunun Haklari*, at 108.

⁹ B.Yalti, *Vergi Yukumlusunun Haklari*, at 110.

¹⁰ P. Baker, P.Pistone, *The Practical Protection of Taxpayers' Fundamental Rights* General Report, at 41.

entire tax procedure.¹¹ On the other hand, the taxpayer must have access to the evidences, information and observations held by the tax administration in order to properly exercise its defense rights. This aspect relates to equality of arms and adversarial principle within the meaning of fair trial rights. This paper focuses on reasonableness in time and equality of arms during tax proceedings.

2. Tax audits to be completed within a reasonable time

Reasonable time is closely linked to the legal certainty and proportionality principle and refers to a period of time. Reasonable time requirement is explicitly regulated in article 6 on fair trial of the ECHR.¹² There is no statutory maximum length of duration within article 6, as well as the ECrtHR does not provide such an absolute length of time in its jurisprudence. However, the ECrtHR tests the reasonableness of the duration according to the special circumstances of each dispute, i.e. complexity of the case, the conduct of the taxpayer (applicant) and the conduct of the judicial and administrative authorities. In general, the duration requirement is directly in relation to the benefits at risk in a certain case.¹³

In case where a tax audit proceeding takes a long period of time, the taxpayer who is under the close scrutiny of the tax administration is in an uncertain position as regard the taxes payable, and late payment interest and the tax penalties

¹¹ See for example the *Janosevic* decision where the ECrtHR characterizes the drafting of the tax audit report as a criminal charge (*Janosevic v. Sweden*, 23 July 2002, Application no. 34619/97).

¹² Article 6(1)- In the determination of his civil rights and obligations or of any criminal charge against him, everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law.

¹³ See, S. Inceoglu, *Insan Haklari Avrupa Mahkemesi Kararlarinda Ortak Yargisal Hak ve Ilkeler*, 2nd ed., Beta, Ist. 2005, at 373.

thereof. Such an ambiguity may jeopardize the tax payer's rights and freedoms, and effect economic decisions and reputation. From this point of view, the duration matters. However, there is no generally accepted length of time to be reasonable. One may start with the statute of limitations of taxes in general and assert that the maximum time limit must be within the statute of limitations set in the domestic law which might have been set differently within the national laws of different states. Such as that time period is five years in Turkey. The legislator requires the tax administration to complete the assessments and notify the taxpayer about the additional administrative decisions within that time.¹⁴ The statute of limitations may not provide an adequate and enough protection for the taxpayer since the law may also provide special events that may interrupt the statute of limitations. For example, the tax auditor may carry the case to the ex officio valuation commission and interrupt the statute of limitation period for one more year.¹⁵ Unfortunately, this opportunity which works in favor of the tax administration may also be misused by the auditors in order to prevent the taxes to be subject to time limitations.¹⁶

¹⁴ Article 114 of the Tax Procedure Act.

¹⁵ Article 114 of the Tax Procedure Act.

¹⁶ B. Pinar, *Yargi Kararlari Isiginda Vergi Incelemesinde Yukumlu Haklarinin Ihlaline Iliskin Tespitler*, *International Journal of Public Finance*, Vol.1, no.1, 2016, at 40. There are decisions where the judiciary did not accept the interruption in cases where the only reason of the case submission to the commission is to be the interruption of the statute of limitations. (See for example Supreme Administrative Court, 9th Chamber, 05.02.2020, E.2017/1408, K.2020/411) However, there are also decisions on the opposite direction (See for example, Supreme Administrative Court, 4th Chamber, 23.01.2019, E.2018/5407, K.2019/434 (For a collection of cases in favor or against see, E. Delitas, *Takdir Komisyonu Kararlarina Istinaden Yapilan Vergi Tarhiyatlarina Yonelik Danistay'in Ictihatleri Birlestirme Karari*

As for a second option, one may argue the time limitation in tax audit proceedings to be regulated by the legislator which is the case in Turkey.¹⁷ Accordingly, tax examination is an investigation to determine and secure the correct amount of tax which must be paid. Taxpayers who are subject to tax examination are those who are legally required to maintain books and to preserve and present the required papers and documents to the authorized agents. Comprehensive tax examinations shall be completed within a year, whereas partial tax examinations in 6 months. VAT examinations, however, must be completed within 3 months. Extension for those time periods (max. 6 months and 2 months respectively) may also be available.¹⁸

The legislator provided a "forseeable" time period -which it characterized as an indispensable element of tax payer's rights- for tax audit proceedings to be completed.¹⁹ Thus, the time limitation in tax audit proceedings is regulated as a "right" in the Turkish legal order. Then one may come to the conclusion that the tax audits that are not completed in due time must be treated as unauthorized intervention and cannot be used as a base for the subsequent assessments. The legal validity of the process, subsequent assessments and penalties, and the evidences collected thereof, depend the procedural conditions to be met.²⁰ Nevertheless, the tax administration,

Vermesi Gerekliligine Dair, Mali Cozum, 31(163), Jan. Feb. 2021, at 241-250).

¹⁷ For other countries see, P. Baker, P.Pistone, General Report, at 41.

¹⁸ Article 140 of the Tax Procedure Act as amended by Law 6009 (Official Gazette of 1 Aug. 2010) and Law 7104 (Official Gazette of 6 Apr. 2018).

¹⁹ See the explanatory memorandum at <https://www.tbmm.gov.tr/sirasayi/donem23/yil01/ss536.pdf>

²⁰ Cf. D.Senyuz, *Vergi İncelemesinde Zaman Bakimindan Yetki*, TAAD, July 2020, no. 43, at 253. Cf. B. Baykara, *Vergi İncelemesinin Belli Surede Bitirilmesine İlişkin Hukmun Niteligi*, Yaklaşım, Dec. 2010, no. 216. For an

basing its approach on the fact that the provision did not contain any sentence about the legal result of the tax audit time limitations, states that exceeding those limitations would only result with the disciplinary action against the auditor.²¹ Furthermore, the judiciary is expected²² to treat the time limitation in the law as a regulatory provision having no legal effect but targeting only the administrative transactions to be done faster.²³

The above result cannot be accepted. If the time limitations are regulated in relation to the taxpayer rights then those limitations must have a binding effect on the tax administration. The interpretation must be done from the point of view of fair trial rights.

One more fact is that a tax audit usually results with additional tax assessments and application of tax penalties and late payment charges. In the opinion of the author those administrative decisions are void since the legal time authorization for the audit has already been completed. Although time duration does not affect the amount of taxes and penalties assessed, the longer the period is the higher the late payment charges are. Then the negligence of the tax auditor or whatever the reason affected the completion of the audit has effects to the detriment of the taxpayer's property rights. Among others, this aspect by itself requires a remedy for the taxpayer. It is interesting that such a result may also be linked to individual application remedies.

opposite view, see T. Erdem, *Vergi Incelemesi*, Yaklasim Yayıncılık, Ankara, 2011, at 140-141.

²¹ Vergi Incelemelerinde Uyulacak Usul ve Esaslar Hakkında Yönetmelik, Official Gazette of 31 Oct. 2011.

²² T. Candan, *Vergi Incelemeleri Bağlamında Mukellef Haklarına Danıştay'ın Bakışı*, 4 Mar.2016, Blog: <https://turgutcandan.com/>

²³ M. Oncel et.al, *Vergi Hukuku*, 17. ed., 2009, Turhan, Ankara, at 114-115.

Whether a legal condition of audit time limitation is or is not included in the law, the audit time period shall eventually affect the overall time duration on a specific taxpayer. Let's assume that the judicial proceedings about those tax assessments and penalties end up with the Turkish Constitutional Court (TCC) via individual application. It is obvious that the time periods of tax audit will have a cascade effect on the reasonable time requirement of the overall proceedings. This result may be the outcome of the approach that the audit proceedings are covered under the criminal limb of the fair trial rights. However courts that do not comply with the result of the *JB* decision of the ECtHR and do not consider the tax audit proceedings as a criminal charge - likewise the TCC²⁴- may interpret the civil rights and obligations limb of the fair trial rights by way of departing from the jurisprudence of the *Ferrazzini* case - likewise the TCC²⁵- and include the audit periods in the calculation of overall reasonable time considerations. It is important to emphasize that the TCC follows the well-known approaches in the literature²⁶ by the following remarkable statement: "*Legal dispute proceedings that falls under the public law, but by its results thereof determines individual rights and obligations, are covered by the protection of article 6 of the*

²⁴ TCC, 31 Jan. 2007, E. 2004/31, K. 2007/11 (Official Gazette of 18 May 2007).

²⁵ See B. Yalti, *The Constitutional Court's Inaugural Decision Regarding the Fair Trial Rights of Taxpayers*, 55 Eur. Taxn. 10 (2015), Journal Articles & Papers IBFD.

²⁶ P. Baker, *The Decision in Ferrazzini: Time to Reconsider Application of European Convention of Human Rights in Tax Matters*, Intertax, vol.29, No.11, 2001, at 360 et. seq; P. Baker, *Should Article 6 ECHR (Civil) Apply to Tax Proceedings?*, Intertax, vol.29, No. 6-7, 2001, at 205 et.seq; B.Yalti, *Vergi Yukumlusunun Haklari*, at 91 et.seq.

Convention and article 36 of the Constitution."²⁷ It is obvious that the taxes are read here in relation to property rights and obligations. In this case the conduct of tax auditors may also be included in the determination of the overall time period.

3. Tax audits to be based on equality of arms

As it is well-known, equality of arms can be derived from the concept of fair hearing and have close relationship with the adversarial trial principle. According to the ECrtHR, "*equality of arms*" implies that each party must be afforded a reasonable opportunity to present his case - including his evidence - under conditions that do not place him at a substantial disadvantage vis-à-vis his opponent."²⁸ Adversarial trial principle is derived from the equality of arms concerning a party to a dispute is required to be informed and granted the other parties evidences and observation so that he has the opportunity to discuss and object the content of them.²⁹ Those principles imply a balanced equality between the tax administration and taxpayer during the tax proceedings and refer to the right to access the evidences and documents acquired by the administration and right to be heard, discuss and submit objections and counter evidences.³⁰ All those concepts of course are in relation to the rights of defense.³¹ There is no doubt that such rights of the inspected taxpayer must be protected.

²⁷ TCC, Garanti Bankasi, 16 Nisan 2015, Application no. 2013/4553 (Official Gazette of 13 July 2015).

²⁸ *Dombo Beheer BV v. The Netherlands*, 27 Oct. 1993, Application no. 14448/88, para 33.

²⁹ Inceoglu, at 221.

³⁰ B. Yalti, *Vergi Yukumlusunun Haklari*, at 125 et.seq.

³¹ B. Yalti, *Vergi Yukumlusunun Haklari*, at 125. See also, B. Yalti, "*Vergi İncelemelerinde Dinlenilme Hakkı*", *Vergi Sorunlari dergisi*, no. 332, May 2016, at 53.

However, sometimes, other rights such as confidentiality and tax secrecy rights of third parties might occur during tax audits. In such cases the balance between rights and obligations must be established.

The first case for such a problem is the use of secret comparables during transfer pricing audits. The inspector having collected the comparable information from third party taxpayers does not inform the inspected taxpayer about that information used and data received because of the tax secrecy obligations vested on the inspector by the law. The inspector using those data for recalculating the transfer prices between related parties may ask so many questions and request answers about the facts that are not known by the inspected taxpayer himself. Furthermore, that third party information is not included in the audit report by the auditor referring to the tax secrecy provisions. It is obvious that a taxpayer cannot object and raise counter arguments where he does not know the content that may be subject to objection. This situation definitely infringes the fair trial and defense rights of the inspected taxpayer since evidences used for the assessments kept secret from the inspected taxpayer.³² The judiciary, however, may still protect the fair trial rights of the taxpayers. For example, the Supreme Administrative Court decides in Turkey against the secret comparable use and protects fair trial rights of the inspected taxpayers by referring the equality of arms principle.³³

³² See B. Yalti, "Transfer Fiyatlandirmasinda Gizli Emsal", Vergi Sorunlari Dergisi no. 251, December 2009. See also, B.Yalti, "Turkey National Report", in The Practical Protection of Taxpayers' Fundamental Rights, General Reps. P. Baker, P.Pistone, IFA Cahiers, vol.100B, IBFD, The Netherlands, 2015, at 817 et.seq.

³³ SAC, 9th Chamber, 15 Oct. 2018, E. 2014/6567, K. 2018/6216 (<https://www.lexpera.com.tr/ictihat/danistay/9-d-e-2014-6567-k-2018-6216-t-15-10-2018>). The SAC in this decision explicitly refers to the *Hentrich*

The second case against the defense rights of the taxpayers is the secret technical report applications.³⁴ Technical reports are joint tax audit reports including evidence and data about more than one taxpayer in relation to each other with respect to the inspected transactions. This kind of information and reports are not provided to the taxpayer since it included third party information which must be kept as secret. Although the technical reports are used as the base of a single tax audit report drafted for a specific taxpayer, those reports are not attached to the subsequent tax assessments and tax penalty decisions. Although the ordinary audit report is required by law³⁵ to be attached to the assessment and penalty decisions that audit report is a very short version of the technical audit reports and makes only reference to the technical report where no information is revealed. Taxpayers have the right to receive a full report on the conclusions of the audit and learn the background reasoning of the tax assessment decision.³⁶

Initially, the SAC decided against the tax administration and ruled that insufficient information on the assessment about a taxpayer would not satisfy the goal of allowing the taxpayer to exercise his defense rights and has cancelled the decision

decision of the ECtHR stating that " one of the requirements of a "fair trial" is "equality of arms", which implies that each party must be afforded a reasonable opportunity to present his case under conditions that do not place him at a substantial disadvantage vis-à-vis his opponent" *Hentrich v. France*, 25 Aug. 1994, Application no.23/1993/418/497, para.56.

³⁴ See, B. Baykara, "Dayanagi Baska Bir Mukellef Hakkinda Yazilan Vergi Teknigi Raporu Olan Vergi Incelemeleri, Vergi Tarhiyatlari ve Vergi Davalarinin Bireysel Basvuru Hakki Bakimindan Incelenmesi", Vergi Dunyasi, no.398 October 2014, at 63.

³⁵ Article 34 of the Tax Procedure Act.

³⁶ B. Yalti, Turkey National Report, at 819.

because the formal requirements of the law has not been met.³⁷ Later on the SAC unexpectedly changed its jurisprudence. The court admitted that the taxpayer has a right to receive the audit reports however this requirement can also be met during the litigation itself. If this lack of information is eliminated within the subsequent phases of the trial then the administrative decisions should not be considered as void.³⁸ This jurisprudence can be characterized as a step back from the protection of taxpayer's rights.

³⁷ See for example, SAC, Third Chamber, 5 July 2001, E.2000/1150, K.2001/2696, (<http://www.kararevi.com>). SAC, 18 June 2014, Grand Tax Chamber, E.2014/304, K.2014/563 (not published).

³⁸ See for example, SAC Grand Tax Chamber, 10 Feb.2016, E.2016/82, K.2016/83(Lexpera database).