
THE TAX DISPUTES AND LITIGATION REVIEW

SECOND EDITION

EDITOR
SIMON WHITEHEAD

LAW BUSINESS RESEARCH

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THE TAX
DISPUTES AND
LITIGATION
REVIEW

Second Edition

Editor
SIMON WHITEHEAD

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EDITOR'S PREFACE

The objective of this book is to provide tax professionals involved in disputes with revenue authorities in multiple jurisdictions with an outline of the principal issues arising in those jurisdictions. In this, the second edition, we have continued to concentrate on the key jurisdictions where disputes are likely to occur for multinational businesses.

Each chapter provides an overview of the procedural rules that govern tax appeals and highlights the pitfalls of which taxpayers need to be most aware. Aspects that are particularly relevant to multinationals, such as transfer pricing, are also considered. In particular, we have asked the authors to address an area where we have always found worrying and subtle variations in approach between courts in different jurisdictions, namely the differing ways in which double tax conventions can be interpreted and applied.

Perhaps it is merely a perception from a jurisdiction whose prime minister has publicly vilified a multinational for complying with the national tax laws, but tax avoidance seems to have become the new international evil. As such, this book provides an overview of each jurisdiction's anti-avoidance rules and any alternative mechanisms for resolving tax disputes, such as mediation, arbitration or restitution claims.

We have attempted to give readers a flavour of the tax litigation landscape in each jurisdiction. The authors have looked to the future and have summarised the policies and approaches of the revenue authorities regarding contentious matters, addressing important questions such as how long cases take and situations in which some form of settlement might be available.

We have been lucky to obtain contributions from the leading tax litigation practitioners in their jurisdictions. Many of the authors are members of the EU Tax Group, a collection of independent law firms, of which we are members, involved particularly in challenges to the compatibility of national tax laws with EU and EEA rights. We hope that you will find this book informative and useful.

Finally, I would like to acknowledge the hard work of my colleague Federico Cincotta in the editing and compilation of this book.

Simon Whitehead

Joseph Hage Aaronson LLP

London

February 2014

Chapter 21

SPAIN

*Jesús López Tello*¹

I INTRODUCTION

Tax disputes are relatively common among Spanish taxpayers. On a fairly frequent basis, scholars, practitioners and even the tax authorities themselves, request legal or practical solutions to reduce tax litigation, which the majority of the participants in the tax arena consider to be dramatically high.

In this regard, the Spanish tax system has implemented binding rulings and advance pricing agreements with reasonable success. Nevertheless, the tax system is part of the Spanish legal system, whose roots stem from Napoleonic-style laws enacted in the 19th and 20th centuries. The written law has absolute supremacy and public economic rights are overprotected. Furthermore, the tax authorities are not empowered to negotiate on tax rights, unless so authorised by a Royal Decree passed by the Spanish government.

Due to the heightened protection in Spanish tax law, arbitration and other alternative dispute resolution mechanisms have yet to be implemented in the Spanish tax system.

Unfortunately, the courts that deal with tax matters are too understaffed to resolve tax disputes within a reasonable time frame. As examined in more detail in this chapter, a Spanish taxpayer who disputes a tax assessment can easily expect a five to nine-year fight before receiving a final decision at the last instance.

II COMMENCING DISPUTES

A tax dispute in Spain is usually initiated by an appeal against an assessment. With the exception of assessments related to local taxes (as described in further detail below), upon the issuance of a tax assessment, taxpayers may file an appeal with either the same tax authority (often, a chief tax inspector) that issued the tax assessment or with the

¹ Jesús López Tello is a senior partner at Uría Menéndez.

economic-administrative tribunals (the tax tribunals) within one month of the taxpayer being notified of the tax assessment.

This manner of commencing a tax dispute in Spain applies to the different types of taxes in general, irrespective of whether the assessment refers to personal tax, corporation tax, wealth tax, indirect tax, stamp duty or to any tax collected by Spain or by any autonomous region of Spain, any political subdivision of the same, or any wholly owned agency or instrument of any of the foregoing.

An appeal lodged with the same tax authority that issued the tax assessment is optional. The tax authority has a period of one month in which to issue a decision. If this term elapses without a decision being issued to the taxpayer, it will be considered that a refusal has been issued. If the tax authority issues a written decision, practical experience demonstrates that decisions favourable to the taxpayer are only granted when the assessment is based on gross legal or factual errors.

On the other hand, an appeal lodged with the tax tribunals is compulsory. To have standing to bring a claim in a court of justice, a Spanish taxpayer must have previously appealed against the tax assessment before the tax tribunals, either directly or after having previously exhausted the optional route available under an appeal before the tax authorities.

As an exception, taxpayers must file an appeal before the tax authorities against tax assessments issued by Spanish municipalities – that is to say, this procedural route is not optional. Once an appeal has been resolved by the local tax authority, any subsequent appeal against the resolution must seek recourse through the courts of justice, thus preventing taxpayers from filing a previous claim with the tax tribunals.

Despite their potentially misleading name, the tax tribunals are not judicial in nature. Tax tribunals form an independent administrative body within the Spanish Ministry of Finance. In our experience, the tax tribunals' decisions tend to be in line with those of the tax authorities. As such, a favourable decision for the taxpayer is quite unlikely unless the tax authorities' assessment is based on gross legal or factual errors. In practice, the tax tribunals act to filter out tax assessments that would be highly unlikely to succeed in a court of justice.

III THE COURTS AND TRIBUNALS

i Economic-administrative appeal before tax tribunals

When filing an economic-administrative appeal, the taxpayer may decide either to file a simple formal appeal notification in which the tax assessment under appeal is identified, or to set out the legal grounds on which the appeal is based.

At some point, usually several months after the filing of the appeal, the tax tribunal will grant the taxpayer a 30-day term to consult the documentation pertaining to the proceedings to submit allegations based on the documentation (or additional allegations if they were submitted when filing the appeal).

The allegations must include both the facts and legal basis of the appeal. It should be noted that the documentation of the proceedings mainly includes the documents submitted and examined during the previous tax procedure (for instance, a tax audit) that gave rise to the assessment. When submitting allegations, the taxpayer may also

request that additional evidence be added to the file. The tax tribunal will then decide whether to admit the additional evidence.

The tax tribunal will issue a decision on the appeal in the following terms:

- a* rejecting the appeal;
- b* totally or partially annulling the assessment; or
- c* closing the proceedings because of extra-judicial satisfaction or the taxpayer's withdrawal.

The decision must be reasoned and in writing.

Pursuant to the regulations governing the tax tribunals, a decision on an appeal should be issued within one year of its filing. However, in view of the tax tribunals' current workload, this is more likely to take around 14 to 24 months from the filing of the appeal.

Regional and local tax courts have jurisdiction over the assessments issued by the regional bodies of the Spanish state tax authorities or by regional or local tax authorities. There is also a Central Tax Tribunal with jurisdiction to decide on appeals against assessments issued by the central bodies of the Spanish state tax authorities, in addition to appeals against decisions issued by the regional and local tax tribunals on amounts exceeding €150,000.

In the case of amounts exceeding €150,000, the first instance before the regional and local tax tribunals is optional for the taxpayer, who can choose to seek recourse directly from the Central Tax Tribunal.

ii Contentious-administrative appeal against the resolution of tax tribunals before the courts of justice

If the tax tribunal rejects the economic-administrative appeal, the taxpayer can file a contentious-administrative appeal before a court of justice within two months of the notification of the tax tribunal's decision (or within six months if one year has elapsed since the filing of the economic-administrative appeal without an express decision from the tax tribunal).

The Spanish courts of justice with jurisdiction over tax matters are: the National Court, which, broadly speaking, hears appeals against decisions of the Central Tax Tribunal; and the high courts of justice, which, broadly speaking, hear appeals against decisions of the regional and local tax tribunals.

In addition, the contentious-administrative courts decide on contentious-administrative appeals filed against local tax assessments. Appeals against decisions issued by contentious-administrative courts may be made before the corresponding high court of justice.

Once an appeal has been filed with the court, the court will request that the tax tribunal whose decision is being reviewed provide the documentation of the economic-administrative proceedings within 20 days of the notification of the request. The tax tribunal will provide the documentation to the court and will notify the State Attorney of the admission of the appeal.

The court will grant the taxpayer access to the documentation of the proceedings to enable him or her to file an application against the tax tribunal's decision and request the examination of evidence within 20 days.

The court will also provide the State Attorney with the documentation of the proceedings to enable him or her to submit allegations against the taxpayer's application and request the examination of evidence.

The court will decide whether to allow the examination of evidence requested by the taxpayer and the State Attorney. If admitted, the evidence will be examined in the presence of one or more judges hearing the appeal.

Before the decision is issued, the taxpayer and the State Attorney will be requested to file a document with their conclusions on the evidence submitted and the legal arguments and facts underlying their position.

The court will issue a ruling within 10 days of the proceedings being declared finished. Three judges will decide the outcome, although only one will draft the decision.

In practice, these types of proceedings take between 18 and 36 months.

iii Cassation appeal against the ruling of the court before the Supreme Court

An adverse ruling from the National Court may be appealed before the Supreme Court through an appeal of cassation within 10 days of the taxpayer being notified of the ruling.

The Supreme Court is the highest judicial court in Spain in all areas of law; its decision is final and binding, and thus is not subject to appeal (except if the appeal is based on an infringement of the Spanish Constitution). In this regard, only an extraordinary appeal for review is possible in the event of the discovery of previously unknown documents or facts that could potentially have changed the outcome of the Supreme Court's judgment.

To file a cassation appeal, a document must be submitted to the court whose sentence is under review, stating the reasons why the court's ruling is being appealed and that all legal formalities have been satisfied. *Inter alia*, in an ordinary cassation appeal, the amount of the tax assessment at issue must exceed €600,000. If the document is submitted correctly, the court will grant the taxpayer 30 days to file the appeal before the Supreme Court. The court will then provide the documentation of the proceedings to the Supreme Court.

The cassation appeal must include all the arguments to support the filing of the appeal and the law or regulation infringed by the court's ruling. It is important to note that the Supreme Court will not admit any argument based on an assessment of the facts or a new examination of the evidence submitted; proven facts declared by the sentence appealed against in cassation have the effect of *res judicata* for the purposes of cassation appeals.

The Supreme Court will decide on the admissibility of the appeal. It may be admitted on the basis of one or several arguments put forward by the taxpayer. If it is admitted, the Supreme Court will provide the State Attorney with the appeal documentation so that he or she can make allegations against the appeal within 30 days of notification.

The ruling of the Supreme Court will be issued within 10 days of the proceedings being declared ended. In practice, proceedings before the Supreme Court take three to four years.

iv Referral for a preliminary ruling to the Court of Justice of the European Union

The taxpayer may, at any time during the proceedings, request the Central Tax Tribunal, the courts or the Supreme Court to make a referral to the Court of Justice of the European Union (CJEU) for a preliminary ruling on the interpretation or application of European law.

In contrast to other judicial proceedings, a referral for a preliminary ruling is not an appeal against a European or Spanish law, but rather a consultation on the application of European law. The procedure is open to national courts of all Member States; therefore, a Spanish taxpayer may request any Spanish court to consult the CJEU on the interpretation or transposition of European law into Spanish law.

The national court is not obliged to consult the CJEU if it considers the interpretation or the application of the relevant European law in Spain to be clear and in no need of further clarification. National courts may:

- a* make sure of the interpretation or validity of the Spanish tax law pursuant to European law; or
- b* decide to refer a question to the CJEU for a preliminary ruling when uncertain on a particular aspect of a European law.

The decision to consult the CJEU will lead to a stay of the national proceedings until the formal answer has been received. However, the national court may order preventive interim measures if necessary.

The CJEU must send its answer to the national court within a term, in practice, of 18 months. If the application of European law is correct, the national proceedings will resume. Otherwise, the CJEU's decision will be binding on the national court. Furthermore, in the context of a preliminary ruling concerning validity, if a Spanish tax law is declared contrary to European law, the authorities must rectify this situation.

Even if the national court decides not to refer to the CJEU for a preliminary ruling, the taxpayer may submit a complaint to the European Commission stating that Spain has failed to meet its obligations under European law by transposing the law such that it is contrary to European law.

In this case, the European Commission may, at its discretion, initiate proceedings against Spain on the grounds that it has failed to comply with European law. When the Commission initiates proceedings, it must first address a reasoned opinion to the Member State that has failed to comply with European law. If, after a certain period, the Member State has failed to rectify this situation, the Commission may present the case against the Member State to the CJEU.

Once the matter has been referred to the CJEU, if the Court finds that there has been a failure to fulfil any obligation, it will issue an initial decision with the measures to be adopted by the Member State to rectify the situation. If the Commission subsequently considers that the Member State has not implemented the necessary measures, the case will be presented before the CJEU a second time. If the Court confirms that the Member State has not complied with the initial judgment, sanctions may be imposed.

IV PENALTIES AND REMEDIES

i Administrative sanctions

Unpaid tax quotas assessed by the Spanish tax authorities may give rise to the imposition of administrative sanctions if this failure to pay is considered fraud or negligence. Pursuant to the General Tax Law currently in force (GTL), enacted in July 2003,² the taxpayer could be subject to sanctions ranging from 50 to 150 per cent of the unpaid tax.

However, sanctions would range from 100 to 150 per cent of the unpaid tax if fraudulent actions had taken place, such as a failure to comply with accounting obligations, use of false invoices or documents, or the use of a frontman or figurehead.

Administrative sanctions always include delay interest on the amounts due and unpaid by the taxpayer (5 per cent since 2010, on an annual basis).

ii Tax criminal offences

Fundamental Law 7/2012 of 27 December, on transparency and combating tax and social security fraud, has significantly amended the regulations on tax fraud in the Spanish Criminal Code.

Tax fraud can be committed by any taxpayer that, by act or omission, defrauds the Treasury (state, regional or local) by:

- a* avoiding the payment of taxes on amounts withheld (or on amounts that should be withheld), or on deposits;
- b* obtaining undue tax refunds; or
- c* obtaining undue tax allowances.

For tax fraud to be considered a criminal offence, the defrauded tax liability, withheld amounts, deposits, tax refunds or tax allowances unduly obtained or benefited from must exceed €120,000. The mere filing of tax returns or self-assessments does not exclude fraud, if this can be evidenced by other means.

The sanction for tax fraud is one to five years of imprisonment and a fine of six times the defrauded amount. Additionally, the taxpayer guilty of the fraud will forfeit the right to obtain grants, aid, tax or social security allowances or incentives for three to six years.

Pursuant to Article 305-bis of the Criminal Code, introduced by Fundamental Law 7/2012, tax fraud will be punished by two to six years of imprisonment and a fine of two to six times the defrauded amount if:

- a* the defrauded amount exceeds €600,000;
- b* the tax fraud is committed within a criminal organisation or group; or

2 Ley 58/2003, de 17 de diciembre, General Tributaria.

- c* one of the following conceals or hinders the identification of the taxpayer (or of the guilty person), the determination of the defrauded amount or the assets of the taxpayers (or of the liable person):
- nominee individuals, legal persons or entities without legal personality;
 - trusts or other similar instruments; or
 - tax havens or territories without taxation.

In such cases, the statutory limitation period for the prosecution of tax fraud increases from five to 10 years.

In addition to the above sanctions, the person guilty of the fraud will forfeit the right to obtain grants, aid, tax or social security allowances or incentives for four to eight years.

If the tax authorities perceive that a certain tax evasion may constitute tax fraud, it will send a copy of the administrative file to the Public Prosecutor in order for the latter to initiate the relevant criminal proceedings.

Finally, in the case of tax fraud committed by a legal person, in addition to the sanction applicable to the natural person (i.e., the *de facto* or *de jure* director) declared to be guilty of tax fraud, the legal person will also be guilty of this criminal offence (pursuant to Article 31-bis of the Criminal Code) and will be sanctioned with:

- a* a fine of twice the defrauded or improperly obtained amount, if the criminal offence committed by the natural person establishes a sanction of over two years of imprisonment; or
- b* a fine of two to four times the defrauded or improperly obtained amount, if the criminal offence committed by the individual person establishes a sanction of over five years of imprisonment.

Moreover, the offending legal person will be unable to obtain grants, aid, tax or social security allowances or incentives for three to six years. A prohibition on participating in official contracts may also be imposed on the legal person, as well as other additional sanctions.

V TAX CLAIMS

i Recovering overpaid tax

As a general rule, overpaid tax can arise in Spain under two circumstances: overpaid tax deriving from payments on account made in excess of the final tax liability; and overpaid tax deriving from errors committed by the taxpayer when filing a tax return.

Overpaid tax deriving from payments on account made in excess of the final tax liability

Some Spanish taxes oblige the payer of income obtained by the taxpayer (personal income tax) or the taxpayer itself (corporation tax) to make advance payments on account of the final tax liability that will be determined later in the corresponding tax return.

In such cases, payments on account will be offset against the final tax liability and the excess, if any, must be refunded to the taxpayer. The tax authorities have six months in which to proceed with the refund. Otherwise, the taxpayer will have the right to obtain the refund with delayed interest.

Overpaid tax deriving from errors committed by the taxpayer when filing a tax return

Once a tax return has been filed, taxpayers may request the rectification of the return filed and the recovery of overpaid tax if they believe their interests have been harmed by an error in the tax return. The tax authorities will verify the information provided by the taxpayer supporting the rectification of the tax return, and must issue a resolution within six months of the filing of the claim seeking the rectification and refund of taxes paid in error. If no such resolution is issued, the claim will be deemed to have been rejected.

A written or deemed rejection of the claim seeking rectification and refund of taxes paid in error is equivalent to an assessment for the purposes of initiating a tax dispute and will follow the route described in Sections II and III, *supra*.

ii Challenging administrative decisions

The Spanish legal system is based on civil law, and therefore on the supremacy of written law. As such, taxpayers are only permitted to challenge an administrative decision if they allege that the tax authorities' decision is contrary to the law. In that event, the taxpayer is required to reason and evidence the infringement of the tax legislation by the tax authorities.

iii Claimants

Pursuant to the GTL, taxpayers, and any person whose legitimate interests have been or could be affected as a result of the tax authorities' decision, will be entitled to dispute the tax.

Regarding VAT, under Spanish law both the taxpayer who charges the VAT and the recipient of the transaction who bears the economic burden and pays the tax have standing to file a tax claim in connection with the refund of unlawful VAT levied on the transaction.

VI COSTS

Appeals before the tax authorities and before the tax tribunals are cost-free. It is not compulsory to hire a lawyer or a court agent to act as an intermediary between the lawyer and the court. At this stage, no judicial tax is levied.

However, appeals before judicial courts imply costs, specifically lawyers' fees, court agents' fees and judicial taxes.

Court agents' fees are calculated in accordance with the rules approved by the Spanish Ministry of Justice and, as a general rule, are based on the amount claimed in the appeal (e.g., €1,540 on the first €601,012, and €11.24 per €6,010 that exceeds the initial €601,012).

The judicial taxes came into force in December 2012 and are also based on the amount claimed in the appeal. There is a fixed fee that ranges from €200 to €1,200

(depending on the court in which the appeal is filed), and a variable fee that amounts to 0.5 per cent or 0.25 per cent of the amount claimed with a maximum of €10,000.

These costs might be recoverable. The court usually orders the unsuccessful party to pay the appeal costs of the winning party (including lawyers' fees, court agents' fees and judicial taxes). However, it is very common for the court to limit the amount of the costs to be repaid as compensation for lawyers' fees, usually to a maximum of €6,000. Court agents' fees and judicial taxes are normally repaid in full.

VII ALTERNATIVE DISPUTE RESOLUTION

As a general principle, the GTL does not permit any agreements entailing a free disposal of the tax debt by the tax authorities (e.g., reaching an agreement to reduce the tax debt originally due) except where this is limited to granting a new payment schedule to certain taxpayers with transitory cash flow reductions. Following this same approach, the law is extremely reluctant to admit mechanisms for dispute resolution that differ from the traditional route (i.e., a judgment issued by a court or judge). Therefore, in a scenario where the tax authorities have issued a tax assessment, the resolution of any disputes arising from appeals filed by taxpayers (or by the tax authorities themselves) are exclusively deferred to tax tribunals or judicial courts.

As an exception to the above, Spain is party to certain international tax agreements that expressly establish alternatives for the resolution of disputes regarding the interpretation or application of any of its clauses. That is the case with tax treaties with a mutual agreement procedure, under which the countries must make their best efforts to avoid any taxation that is contrary to the tax treaty, and that may even provide a last-recourse arbitration to which the parties should apply if the tax authorities of the countries involved have been unable to reach an agreement (this arbitration may also be available in those tax treaties following the 2008 OECD Model).

Additionally, Convention 90/436/EEC on the elimination of double taxation in connection with the adjustment of transfers of profits between associated undertakings also provides a mutual agreement procedure and an arbitration clause that could be used in cases of transfer pricing adjustment to cross-border transactions within the EU.

The application of these alternative recourses is therefore limited to international situations, and may be also subject to certain limits in the event that the agreement reached by the countries (or by the arbitration body) is not compatible with the eventual decision of a Spanish court on the same matter. In this regard, the Spanish tax authorities will not be entitled to modify that ruling, and the mutual agreement procedure may ultimately have no benefit.

The GTL also grants taxpayers the right to request rulings and advance price agreements from the tax authorities. In the case of tax rulings, the taxpayer may submit to the tax authorities any matter arising from the application of the Spanish tax system, and the content of the ruling will be legally binding on the tax authorities responsible for the application of the taxes not only for the applicant of the ruling, but also for any other taxpayer in the same situation. Concerning advance pricing agreements, their scope is limited to transfer pricing issues (such as the valuation of a transaction or allocation of profits to a permanent establishment), and are negotiated between the tax authorities

and the taxpayer. Their content will be valid and binding on the tax authorities during the time frame agreed by the parties (which cannot exceed four years).

Tax rulings and advance pricing agreements can only be requested before the end of the statutory period for filing tax returns. Therefore, these two instruments cannot be classified as alternative dispute resolution mechanisms, but rather as remedies to avoid a potential dispute with the tax authorities.

VIII ANTI-AVOIDANCE

i General versus specific anti-avoidance rules

As in other countries, abusive or unlawful tax avoidance is defined in Spain by distinguishing between tax evasion and legitimate tax planning.

While tax evasion is understood to encompass ‘illegal arrangements through or by means of which liability is hidden or ignored’,³ tax avoidance is characterised by the use of arrangements that, on their face, seem to be legal. On the other hand, while legitimate tax planning is concerned with taking advantage of fiscally attractive options afforded to taxpayers under the tax legislation, an illegitimate tax avoidance scheme implies that there has been an abuse or misuse of the tax-planning opportunities in the law, and consequently the tax advantages pursued by the taxpayer are refused.

In cases of such a refusal, both general and specific statutory anti-abuse provisions are used in Spain.

At present, the general anti-avoidance rule (GAAR) is contained in Section 15 of the GTL. This provision is designed to counteract acts or transactions that are ‘notoriously contrived or improper for achieving the result obtained’ and that achieve ‘no material legal or economic effects’ other than ‘tax savings and similar effects to those that would have been achieved with the usual or normal acts or transactions’.

In addition to this GAAR, the Spanish tax system also contains specific anti-avoidance provisions. This is the case, for instance, with the withholding tax exemption on dividends distributed by Spanish subsidiaries to EU parent companies. According to a specific anti-avoidance rule included in Section 15, the exemption would not be applied when the EU parent company is controlled, directly or indirectly, by companies or individuals located outside the EU. A similar specific anti-avoidance rule is also found in relation to the reduced withholding tax rate applicable to royalties paid by a Spanish company to an associated EU company.

Specific anti-avoidance rules are also set forth, including for:

- a* exemptions on dividends and capital gains deriving from shareholdings above 5 per cent in active companies located abroad;
- b* exemptions on income obtained by permanent establishments located abroad; and
- c* tax credits for reinvestment in certain circumstances.

3 OCDE (2007): ‘International Tax Terms for the Participants in the OECD Programme of Cooperation with non-OECD Economies’, available at www.oecd.org/ctp/33967016.pdf.

In all these cases, specific anti-avoidance rules limit the scope of the application of advantageous tax provisions.

Since the purpose of this section is to provide an insight into the Spanish GAAR, we have not reviewed in detail the specific anti-abuse provisions established in Spanish tax law. However, the prevailing position of legal scholars, when tax-avoidance behaviour is specifically addressed by a specific statutory anti-abuse provision, is that lack of compliance with the prerequisites of this specific provision cannot be resolved by the tax authorities through the application of the GAAR to classify the taxpayer's behaviour as unlawful tax avoidance.

ii Legal versus case law definition; the birth of the modern Spanish GAAR

In Spain, the concept of illegitimate or abusive tax avoidance has traditionally been linked to the notion of the abuse of law, which was first construed in Spanish law by case law and scholars, and subsequently codified in Section 24 of the old GTL of 1963 and finally included in the Civil Code of 1974.

For civil law purposes, abuse of law is defined as the application of a law outside the purpose for which it was enacted with the aim of infringing the prohibition or the obligation contained in a different law. According to the Supreme Court, the principle of *fraus omnia corrumpit* is common to the different areas or parts of the whole legal system, and this implies that it can also be applied in the tax field.

As mentioned previously, the abuse of tax law was codified in Spain with the enactment of the GTL of 1963 (Section 24). However, its application encountered several pitfalls: it required a subjective or intentional element (the purpose of avoiding payment of tax) that was difficult to prove, it failed to provide any criterion to distinguish the purpose of avoiding the payment of tax from the purpose of legitimately minimising the tax burden, and it included the avoidance of the taxable event, although its wording did not allow for the extension of its scope to include avoidance schemes aimed at reducing the taxable base of the tax burden. In addition, a special procedure was required to qualify a transaction as an abuse of tax law, and the imposition of sanctions was expressly excluded.

For a long time, the Spanish tax authorities and courts applied the concept of the abuse of tax law as a last resort. As such, although the concept had been codified in tax law since 1963, the legal response to what was perceived as abusive or aggressive tax planning was based on the qualification for tax purposes of the acts and contracts carried out by the taxpayers (which were often qualified as tax shams if they lacked the purpose for which the legal system afforded them protection) or on a different construction of the statutes in question without expressly invoking the application of the abuse of tax law.

However, this trend seems to have changed in recent years, as the tax administration has made more frequent use of the new GAAR to challenge aggressive (and sometimes not-so-aggressive) tax planning schemes.

The new GAAR was enacted in 2003, and its wording is designed to extend the scope of its application to cases not provided for in the old GTL, to eliminate the subjective or intentional element, and to provide objective criteria to decide whether an abuse exists.

iii Relevancy of tax motivations: scope of the abuse of tax law

It is generally accepted that tax motivations do not automatically imply the existence of an abuse of tax law. This assumption is grounded both in the belief that the taxpayer's motivations are not relevant for the purposes of interpreting statutory provisions and constructing facts, and in the wide recognition of the possibility of legitimate tax planning, pursuant to which tax motivations invariably exist.

Courts and tax tribunals have repeatedly stated that taxpayers may arrange their own affairs to minimise their legal tax burden. That is, taxpayers may carry out transactions that result in reduced taxation insofar as the transactions are not fictitious or an abuse of law.⁴ A taxpayer may choose the most advantageous route from a tax perspective provided there is no abuse of law.

For that reason, although it cannot be denied that, in order for the tax administration and courts to qualify behaviour as an abuse of tax law, tax motivations are a necessary ingredient of the taxpayer's behaviour, the existence of an abuse of tax law cannot be grounded exclusively in the taxpayer's motives. Motives are difficult to prove, do not reveal any ability to pay tax and are not even relevant for the qualification of legal contracts and transactions. It may even be argued that taxation should focus on the economic effects of the transactions carried out by taxpayers and not on the underlying motives.

Therefore, most Spanish scholars assert that the essence of the abuse of tax law must be based not on the taxpayer's motive of obtaining tax savings, but on the artificiality of the pattern chosen to achieve that objective. Thus, the essence of the abuse of tax law, as traditionally construed by our courts and legal scholars, lies in the existence of a series of actions or business 'unrelated to the normal course of business', where there is an intent to have recourse to a legal rule 'other than the rule that would be likely to lead to a different economic result'. It is this abnormality (or lack of connection between the form chosen and the result obtained) as a typical element of an abuse of law that was further highlighted by the Central Tax Tribunal in its decision dated 28 March 2004, which stated that 'the essential element of legitimate tax planning is that the very typical result of the transactions carried out, rather than any other result, is the result actually intended'.

This relation between artificiality and abuse of tax law is also maintained in the modern Spanish GAAR (Section 15 of the GTL enacted in 2003), which has eliminated

⁴ Central Tax Tribunal, decision dated 28 February 1996; High Court of La Rioja, judgment dated 13 July 2000 (JT 2000, 1577, Legal argument No. 7); High Court of Navarra, judgment dated 11 June 2001 (JT 2001, 719, Legal argument No. 6); Constitutional Court, judgment dated 31 October 1996, 137/1996 (Legal argument No. 2). See also case law of the Supreme Court in a judgment dated 2 November 2002 holding that 'taxpayers may select, among the different alternatives offered by the law, that which is more advantageous for their interest, including whichever alternative may prove more beneficial from a tax perspective'; and a judgment dated 24 May 2003, in which the Spanish Supreme Court endorsed the 'alternative use of tax rules with the purpose of paying less tax' by qualifying such use as 'fully legitimate, provided always that any contractual scheme used is real and there is no attempt to evade a tax'.

from its wording the requirement that there exist a 'purpose of avoiding payment of tax' for a transaction to be qualified as abusive tax avoidance, and which has substituted this subjective element with a two-part test. Thus, under the new GAAR, an abuse of tax law is deemed to include acts or transactions that are 'notoriously contrived or improper for achieving the result obtained' and that achieve 'no material legal or economic effects' other than 'tax savings and similar effects to those that would have been achieved with the usual or normal acts or transactions'.

iv Justifying reasons that exclude the existence of an abuse of tax law

Economic substance

As explained above, a lack of economic substance is necessary to the concept of unacceptable tax avoidance under Spanish law.

This means that, under the GAAR currently in force, the existence of legal or business consequences of a given transaction should be sufficient to preclude the risk of a transaction being classified as an abuse of law. Nevertheless, it is important to take into consideration that there exists the requirement that such effects be material; that is, leaving aside any tax effects deriving from the relevant action, there is a substantial change to the taxpayer's position in legal or economic terms.

Valid economic motives

Unlike many specific anti-avoidance rules that expressly exclude the existence of unacceptable tax avoidance when the taxpayer produces evidence of any commercial reasons it may have to carry out a transaction that, *prima facie*, is presumed to be abusive, the modern Spanish GAAR does not elaborate on the scope of unacceptable tax avoidance by reference to the lack of economic motives, but rather by reference to the existence of a notorious patent artificiality in the taxpayer's transactions. However, as previously mentioned, it cannot be disregarded that the artificiality of a transaction may be derived from the use of an unusual or inadequate approach to achieve a given result when that path cannot be justified by economic or other relevant non-tax motives.

If this were the case, the existence of valid economic reasons would preclude the transaction from being qualified as abusive tax avoidance on the basis that the non-tax motives may justify the artificiality of the path chosen by the taxpayer to achieve a given result.

IX DOUBLE TAXATION TREATIES

Under Spanish law, provisions established in international treaties and conventions prevail over contrary or incompatible domestic rules. The Spanish tax authorities are fully aware of this fact, and the cases in which they fail to observe this hierarchy are extremely rare. Naturally, discussions are currently being held with the tax authorities regarding the correct interpretation of relevant provisions or rules of tax treaties or conventions, which are resolved through appeals lodged with the Spanish or international courts (in the case of the European Court of Justice), or by recourse to a mutual agreement procedure, or arbitration, as may be provided by a treaty or convention.

There are no specific domestic rules or guidelines regarding the interpretation of tax treaties. However, case law exists that deals with specific interpretations of some of the provisions of international law based on specific discussions submitted to the tax authorities, tax tribunals and judicial courts. Nevertheless, in the interpretation of tax treaties and conventions, the Spanish tax authorities take into consideration opinions issued by the OECD, such as, in particular, the revised version of comments on the Model Tax Convention on Income and on Capital or the transfer pricing reports (Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations). Additionally, Spain is a signatory to the 1969 Vienna Convention on the Law of Treaties, which is important in connection with the interpretation of general matters concerning tax treaties and conventions.

Finally, the application of domestic tax law is conditional upon the norms established at the level of the EU, either as a prohibition to any discrimination contrary to the freedoms declared in the Treaty on the Functioning of the European Union or as an obligation to coordinate laws on any areas (such as regulations on value added tax). The Spanish tax authorities usually respect these limits and do not apply any tax law that has been considered contrary to EU law, even if it has not been formally derogated through a new provision. To interpret the limits within the scope of the EU, taxpayers and the tax authorities themselves usually rely on precedents of the European Court of Justice (case law) as well as on opinions issued by EU bodies (such as the Commission).

X AREAS OF FOCUS

Experience in recent years demonstrates that the following areas are of special concern for the Spanish tax authorities:

- a* business combinations that have applied the special tax regime under the Spanish transposition of EU Council Directive 90/434/EEC on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States;
- b* leveraged buyouts, which in Spain have given rise to substantial amounts of financial expenses and goodwill depreciation;
- c* intra-group transactions by virtue of which a Spanish subsidiary acquires a foreign subsidiary from a related party with funds borrowed from the foreign parent company of the group, resulting in exempt income at the Spanish tax level (dividends from the acquired foreign subsidiary) and deductible expenses (interest paid to a related lender);
- d* disinvestments in Spain through share buy-backs involving a capital reduction, whose purpose is the return of contributions to the shareholders; and
- e* non-resident entities obtaining large amounts of Spanish-sourced income with, allegedly, no permanent establishment on Spanish territory.

XI OUTLOOK AND CONCLUSIONS

Among the subjects that may be prevalent in Spanish tax litigation in the near future are the following:

- a* the intensive use by the Spanish tax authorities of specific anti-avoidance clauses, particularly those based on a lack of valid economic reasons to carry out the transaction under discussion. This trend, currently backed by the Spanish courts, will very likely continue in the future;
- b* the increasing use by the Spanish tax authorities of clauses on the limitation of benefits under tax treaties;
- c* the consistent use by the Spanish tax authorities of the doctrine of simulation (borrowed from civil law) as the real general anti-avoidance tax rule, in lieu of the GAAR set forth in Section 15 of the GTL. It certainly may be said that this trend has been broadly accepted by the courts;
- d* new thinking on the traditional definition of 'permanent establishment' linked to the idea of a 'fixed' place of business, particularly in connection with business activities primarily carried out through the internet;
- e* the close control of the tax consequences of the international migration of legal and natural persons formerly resident in Spain;
- f* the routine use of information collected using the exchange of information mechanisms under tax treaties and other international agreements for supporting cases before the courts; and
- g* the ordinary use of criminal investigations for dealing with transactions that may involve the potential evasion of high amounts of tax.

On the other hand, the Spanish government appointed a committee of experts in July 2013, entrusting them with the heavy task of modernising the entire tax system, looking for sufficiency, efficiency and equality. These experts will present their report on the tax system reform some time before March 2014.

Shortly following this report it is expected that year 2014 will see draft legislation intended to adapt Spanish statutory provisions about tax disputes to this future framework.

Appendix 1

ABOUT THE AUTHORS

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Jesús López Tello is a lawyer at the Madrid office of Uría Menéndez.

He qualified in 1986 as a state treasury inspector (ranked number one in his class), and in 1989 as an inspector of insurance and pension plans and funds. After nine years serving in the Spanish tax authorities, he joined Uría Menéndez in 1995 as a partner to develop the firm's tax practice.

Jesús regularly advises clients on M&A, business combinations, structuring groups and activities, taxation of financial transactions and issuance of equity and debt instruments. He is also actively engaged on tax litigation matters, such as tax investigations, tax disputes and tax criminal offences.

He is regarded as a leading lawyer by the main international legal directories, including *Chambers Europe Guide* and the *International Who's Who of Business Lawyers*.

He gained his law degree from the Complutense University of Madrid in 1982.

He is a member of the Ilustre Colegio de Abogados de Madrid, the International Fiscal Association and the Latin American Association of Tax Arbitration.

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