QUESTIONNAIRE "THE BURDEN OF PROOF IN TAX MATTERS", EATLP CONFERENCE, MAY 2011, ATHENS, GREECE.

(SPAIN)

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PART. A. NATIONAL CONCEPTS

General rule on the burden of proof

***1.Question*: Does such a general rule exist in your legal system? Is it based on the law or on tax practice? If such a general rule does not exist, how is the burden of proof allocated? Do different rules apply for proceedings in the tax administration, the tax courts or the criminal courts?**

In Spain, the general rule concerning the division of the burden of proof is provided in Article 105 *of* the Spanish General Tax Law, which states that a person who desires to make a right effective must prove the facts underlying this right. Based on Spanish law, this rule has mostly been interpreted by the tax courts to mean that the tax administration has to prove the income-side and the taxpayer has to prove the cost-side, following the traditional Rosenberg's theory for Civil Procedural Law. In tax courts, this general rule is usually combined with other criteria such as the requirement for each party to provide the evidence that is easiest for it to gather, which usually leads to the same result since it is normally easier for the tax administration to prove that income has been received and for the taxpayer to prove that costs have been made. However, the opposite could also be true. Sometimes in the tax courts the principle of good faith (principle of abuse of law), originated in civil procedural law is also applied, which could shift the burden of proof to the taxpayer.

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Besides this general rule, there are also other secondary rules provided under Spanish law, which are to be applied only to presumptions. In presumptions there is a reversal of the burden of proof upon the taxpayer, who must prove that there is no relationship between the true fact and the presumed fact.

There also is also a special rule concerning the burden of proof in the case of criminal procedures on tax matters where a tax penalty is being imposed. In such cases, the tax administration must prove the underlying facts relating to the tax violation due to the aphorism *in dubio pro reo*. This is also valid for administrative tax proceedings to impose sanctions.

***2.Question*: In your country, do different rules of burden of proof apply depending on the period of time in which the decision on the tax dispute is being made? Where does the burden of proof lie where a tax penalty is being imposed?**

In Spain, , the data and facts furnished by taxpayers on their returns or answers to requests for information required by the tax administration are presumed to be true, unless proven otherwise (see Articles 108, 93 and 94 of the Spanish General Tax Law). The purpose of this rule is also to provide legal certainty to the taxpayer's statements.

Therefore, in case of an additional tax assessment, the tax administration has to prove that the taxpayer has provided incorrect/false information, meaning that it bears the burden of proof in the case of both income and cost. This rule is also to be applied when the tax administration intends to use the information provided by a taxpayer against another taxpayer (third person) during the tax procedure. In this case, if the taxpayer claims that the information provided by the third person is false/incorrect, this claim must be verified by the tax administration. Therefore, the tax administration may ask the taxpayer who has provided information relating to the third person to produce evidence of the information provided.

With respect to the rule concerning tax procedures where a tax penalty is being imposed the tax administration must prove the underlying facts of the taxpayer's infringement or offence due to the aphorism *in dubio pro reo* (see answer no. 1 above). This is a general rule established by the tax courts. This rule must also be combined with the general principle of responsibility set forth under Spanish law for administrative or criminal tax procedures where a tax penalty is to be imposed. As provided in Article 188.1 of the Spanish General Tax Law: facts constituting tax violations can only be penalized where the taxpayers involved are liable therefore. This general statement of liability includes both the exclusion from penalties of cases where the conduct is not attributable to the taxpayer and where the conduct attributable to the taxpayer is neither wilful nor does it involve fault (regardless of the degree of negligence).

***3.Question*: How is the burden of proof allocated in discretionary decisions on tax assessments or for estimates in your country? Is the burden of proof different if a tax penalty within such a tax assessment is being imposed?**

In Spain tax assessments may be made by the estimation procedure in certain cases in which it appears to be impossible for the tax administration to verify and determine the underlying facts relating to a tax assessment with certainty. It is regulated in Articles 53 and 58 of the Spanish General Tax Law and Article 193 of Royal Decree 1065/2007, of 27 July. It must be objectively impossible for the tax administration to prove the facts because the taxpayer has failed to fulfil his bookkeeping obligations. Spanish national tax courts have stated that to proceed with the estimation, the taxpayer's failure must be substantial, i.e. where the accounting books or records fail to accurately recognise the ownership of activities, assets or rights; where the books or records contain omissions, alterations or inaccuracies which mask or seriously hinder the transactions performed from being verified; in cases in which, having applied the generally accepted techniques or criteria to the documentation furnished by the taxpayer, the tax return can not be verified or the taxable income subject to verification cannot be accurately calculated; and where the incongruence evidenced between the transactions accounted for or recognised and those which should be recorded in relation to the whole of the purchases, expenses or other aspects of the activity performed suggest that the accounting records or books are incorrect.

In such cases, given that it is possible for the tax administration to estimate there is only a slight reduction in the level of proof, since the tax administration still has to demonstrate that its estimate is "probable",. However, this does not imply that there is a reversal of the burden of proof upon the taxpayers since the tax administration must justify the truthfulness of its assertions (Prof. PALAO). Estimation also means that the facts which need to be proven are different, considering that the tax administration must prove the circumstances giving rise to the estimation of an assessment. Once the tax administration has demonstrated the estimated assessment is probable, then the burden of proof shifts to the taxpayer and he has to provide proof that the estimate is incorrect.

***4.Question*: How is the burden of proof allocated where a tax case contains information that is difficult or impossible for the tax administration to investigate (e.g. where a tax haven is involved)?**

As stated above (see answer no. 1), in Spain the general rule concerning the division of the burden of proof, is that the person who desires to make a right effective must prove the related underlying facts. This is frequently combined with other criteria in tax courts such as the requirement for each party to provide the evidence that is easiest for it to gather. This especially occurs when it is difficult for the tax administration to obtain the relevant information causing tax courts to be particularly inclined to shift the burden of proof upon the taxpayer. These situations are frequent in international transactions or where a tax haven is involved. In relation to tax havens, Spanish national tax law also contains specific anti-abuse clauses, in which the burden of proof is altered, mostly by presumptions. These presumptions often change the object of proof that must be produced by the taxpayer or the tax administration in order to overcome the lack of information that generally affects this type of tax jurisdictions. Examples of this can be found in Articles 9.1.a) of Spanish Income Tax Law and 8.1 and 107.12. 2º of Spanish Corporation Tax Law.

Under Article 9.1.a) of Spanish Income Tax Law, a special tax regime is established for cases where the residence for tax purposes is deemed to be a country or territory considered to be a tax haven. Pursuant to this Article, the tax administration may require the taxpayer to prove that he was present in the tax haven for 183 days or more during a calendar year. In other words, the burden of proof falls upon the taxpayer who is required to demonstrate he was effectively present in the tax haven where he claims to be a resident for at least 183 days during the calendar year. This means that there is an authentic reversal of the burden of proof upon the taxpayer, since the tax administration does not have to prove whether or not the change of residence to a tax haven is real or not, and can require the taxpayer to provide proof extending beyond certified residence for tax purposes in this territory. .

Article 8.1 of Spanish Corporation Tax Law, allows the tax administration to presume that an entity established in a "null taxation country or territory" or in a territory considered to be a tax haven has its residence in Spanish territory if:

- Its principal assets consist, directly or indirectly, of property situated or rights that must be performed or exercised in Spanish territory or
- Its principal activity is carried out in that territory.

According to the presumption established by Art. 8, the tax administration is not required to provide proof of the residence of the entity in Spanish territory, but rather only that one of these circumstances has taken place. On the other hand, the taxpayer (the entity) can rebut the presumption by evidencing the following:

- Its direction and effective management take place in that country or territory, and
- The establishment and operation of the entity are due to valid economic motives and substantive business reasons other than the mere management of securities or other assets.

Consequently, the taxpayer bears the burden of the proof in relation to the fact that the entity has a real economic link to our territory.

Another example of this type of presumptions which change the proof required when having to deal with tax havens can be found in Article 107. 12.2º of *Spanish Corporation Tax Law.* This article sets forth special rules for the implementation of the fiscal transparency regime (*Controlled Foreign Corporation Legislation)* in cases where resident entities in Spain have an ownership interest in resident entities of a tax haven. These special rules basically consist in presumptions affecting the premises for the rules allowing for the implementation of the fiscal transparency regime and the legal consequences of the fiscal transparency regime. In such cases, the tax administration has the burden of proof of the basis for the presumption: the holding of ownership interest by a resident entity in Spain in a resident entity in a tax haven. Obtaining such proof may not be easy for the Spanish tax administration considering the lack of cooperation normally shown by governments of such territories. In any case, the taxpayer may rebut the presumption by means of evidence to the contrary.

***5.Question*: Does your country have a general rule regarding evidentiary requirements? If so, what are the requirements (level of proof)? Is it based on the law or on practice? Do different rules apply to the tax administration, the tax courts and the criminal courts? And are there situations in which the burden of proof is aggravated, for instance when the taxpayer has not fulfilled his bookkeeping obligations?**

In Spain there is no general rule regarding evidentiary requirements. However, it can be asserted that there is a high degree of consensus by legal writers and in case law regarding the use of indirect evidence in relation to tax matters. Despite the fact that such evidence leads to a lesser degree of certainty regarding the reality of the facts, they often rebut other documentary evidence which frequently represent a formal truth. . Such indirect evident is commonly used for the purpose of assessment estimation.

However, the Spanish Constitutional Court has even accepted their use in criminal proceedings and in cases of tax fraud (see, among others, Sentence 174/1985, of 17th December), extending beyond cases of the estimation of taxable income.

The use of this type of evidence is also common in disputes over the residence of the taxpayer for tax purposes, whether these disputes affect the territory of several states, or are between the state and other self-governed regions, i.e. Autonomous Communities. In this type of disputes, there is often a group of indicators (financial transactions, the use of credit cards, sales receipts, etc.) which are used to undermine the appearance of the taxpayer's residence for tax purposes in a given territory.

***6. Question*: What are the evidentiary requirements (level of proof) for discretionary/estimated tax assessments? Are the evidentiary requirements the**

same for tax penalties in such cases? Are the evidentiary requirements different if the tax assessments are being made according to the rules for additional tax assessments (i.e. do such rules exist in your country)?

See answer to question no. 3. As previously discussed, the evidentiary requirements for estimated tax assessments might be considered to be slightly lesser, since the tax administration is only required to demonstrate that its estimate was “probable”, and such estimates are also valid for the imposition of a tax penalty during an administrative tax procedure. When it comes to a criminal procedure the opinion held by most lawyers and professors of criminal law is that a tax penalty should never be imposed over an estimated assessment, which is not certain but only probable.

In relation to the existence of different evidentiary requirements, if the tax assessments are being made according to the rules for additional tax assessments, see answer to question no. 2.

***7. Question*: Are the evidentiary requirements affected by the possibility for the tax administration to investigate circumstances in a case e.g. by means of exchange of information with a country involved?**

Based on the answer to question no. 4 it is clearly often difficult or impossible for the tax administration to investigate situations having to do with tax havens, so in such cases the burden of proof may shift upon the taxpayer (see examples in answer no 4). Spanish evidentiary rules do not usually recognise the influence of whether or not there is an information exchange agreement with the tax haven or the “null taxation country or territory”. However, the fact that there is an exchange of information agreement does influence whether or not the territory is considered to be a tax haven, in accordance with the Black list system implemented under Spanish law. In any case, it is clear that the possibility of exchanging information with a country involved does really affect evidentiary requirements, as the example of Article 9.1.a) of Spanish Income Tax Law demonstrates. Pursuant to this Article, in cases of residence in tax havens, taxpayers may be required by the tax administration to provide additional material evidence of residence other than a certificate of residence for tax purposes.

***8. Question*: Are different evidentiary requirements applicable in your country for different types of taxes?**

Yes, However under the various tax laws in force in Spain there are different rules regarding the evidentiary value of certain evidence depending on the degree of certainty required in each case. For example, in the case of VAT, an invoice is required to prove necessary expenses or deductions claimed.

***9. Question*: Is the evaluation of evidence free or is it in any way limited? Is it statutory or is it based on practice?**

As a general rule, in Spain evidence is evaluated on the basis of the principle of free evaluation of evidence by both the administrative body responsible for implementing tax laws and the judge required to rule on the legality of measures taken in administrative proceedings. This general rule is provided in article 106 of the Spanish General Tax Act, which refers to the rules on means and evaluation of evidence provided under the Spanish Civil Procedural Code. However, this general rule is combined with legal rules on the evaluation of evidence provided under the various Spanish tax laws, of which there are basically two types: evidentiary limitations and rules on evidentiary value. In the former, the law deems one form of evidence to be more or less effective than the others depending on the case, and in the latter, certain forms of evidence (invoice, accounting books) are given a specific evidentiary value, which may be more or less incontrovertible.

PART B: BURDEN OF PROOF IN ANTI-ABUSE PROVISIONS

GENERAL ANTI-ABUSE PROVISION

***10. Question:* Is there a general anti-abuse provision in your (procedural) tax law and which party bears the burden of proof under this provision?**

In Spain, the Spanish General Tax Law provides two general anti-avoidance rules): which are set forth in Article 15 and 16, respectively. These rules establish two general anti-tax evasion mechanisms which are apparently very similar but different in terms of the conditions required for their application by the tax administration and their legal consequences for taxpayers. In practice, the distinction between them is often very difficult because both cases are based on the idea that the operations intended to be performed use a legal form or configuration which does not correspond to the aim they pursue. In Article 15 this practice is combated by means of proceedings based on the figures of abuse of law (French abuse de droit) or potential abuse in legal settings (abuse of rights in Germany). In Article 16 the figure of sham is provided.

Article 15 of Spanish General Tax Law sets forth a general mechanism for combating tax fraud whose features are very similar to those of the German mechanism established in Sec. 42 of the General Tax Code. Thus, fraud is deemed to exist where the performance a taxable event is partially or completely avoided or the taxable income or tax liability is decreased by means of actions or transactions in which the following occurs: a) where, considered individually or collectively, they are manifestly artificial or inappropriate for achieving the result obtained (b) their use does have relevant legal or commercial effects other than tax savings and the effects which would have been obtained by means of usual acts or transactions".

Therefore, for the tax administration to be able to declare the acts or transactions to have been performed fraudulently (avoidance transactions) it must be evidenced that they are manifestly artificial or inappropriate for the purpose of achieving the result obtained and that these acts or transactions have not been performed for valid commercial or legal reasons other than to obtain tax savings. Spanish law includes two anti-fraud techniques already known in common law as "substance over form" and the "business purpose test", which must also be applied concurrently as in German case law, where the analysis of the other reasons for the transaction is essential for determining whether the form is or not appropriate for the purpose achieved by the parties (RUIZ ALMENDRAL). This is evident because it is not only the tax benefit obtained which determines the existence of abuse or a transaction performed fraudulently, but the way in which it was obtained given the features intrinsic to the transaction (PALAO TABOADA).

Accordingly, in the new anti-fraud measure established in Article 15, the tax administration is not required to prove fraudulent intent by the taxpayer or that the taxpayer's purpose was to evade tax, but rather that essential elements concur to be able to consider a certain act or transaction to be abusive; i.e. that it was an avoidance transaction. Therefore, it can be concluded that the tax administration continues to bear the burden of proving that the taxpayer's purpose was to evade paying tax. However, under law, a number of objectified factors or circumstances must be found to exist evidencing that there was abuse:

- There is a tax advantage for the taxpayer due to the structure of the transaction adopted.
- The acts or transactions performed are manifestly artificial or improper for the achievement of the result obtained.

- The form chosen for the transaction does not lead to significant legal or commercial effects beyond obtaining a tax advantage.

There is a great deal of presumptive evidence which can subsequently be challenged by the taxpayer by showing proof to the contrary, for example, by proving that the transaction performed was genuine since grounds exist beyond obtaining a tax advantage and the company's business purpose is not artificial. To this extent, the general anti-abuse provision set forth in Article 15 of Spanish General Tax Law provides a two-step mechanism, similar to the one provided by Sec. 42 of the German Tax Code.

The other general anti-abuse provision is included in Article 16 of the Spanish General Tax Law, and is also meant to be very similar to the rule provided under Sec. 41 of the German General Tax Code (ZORNOZA PÉREZ). This law sets forth a rule whose purpose is to correct the effects of the tax sham, which provides the following: *"1. In acts or transactions involving a tax sham, the taxable event shall have effectively been performed by the parties. 2. The existence of a tax sham shall be declared by the tax administration in the corresponding tax assessment, and such qualification shall only have tax effects. 3. In the regularisation arising from the tax sham, default interest, as well as the appropriate penalty, shall be applicable".* The tax sham referred to in Article 16 relates either to the legal entity or one of its elements (e.g. date, identity of the parties to a transaction, price, etc.) or to other legal acts (e.g. acts aimed at simulating the appearance of residence in a low tax territory)".

In accordance with the provisions of Article 16 of Spanish General Tax Law, the tax administration has the power to declare a sham to exist without the need to take the corresponding action before the Court by means of additional tax assessments, where according to the general rule concerning the burden of proof established in article 105 of Spanish General Tax Law, the tax administration bears the burden of proof that the facts declared by the interested party constitute a simple appearance resulting from a sham, which should not prevent the taxation of the concealed or hidden event (See ZORNOZA PEREZ).

This criterion for allocation of the burden of proof has also been applied by the Spanish courts when trying tax sham cases, in which they unanimously ruled that the burden of proof of the existence of a sham falls upon the tax administration. However, in case law this allocation of the burden of proof has been softened in two ways. On the one hand, where the tax sham is discussed within the context of tax planning, it is enough for the court to reach a reasonable degree of conviction regarding its lack of real commercial effects for it to be understood that there is a prima facie case of a tax sham, shifting the burden of proof on the taxpayer regarding the effects of and commercial reasons for the transaction questioned as being a sham. On the other hand, both the tax administration in practice and the courts allow for a sham to be proven through circumstantial evidence or presumptions, given how difficult it is to prove such a sham.

Both academic writers and the courts agree that the case of sham provided in Article 16 is the same as the technical and legal definition of a sham set provided under Civil Law: A sham transaction exists where another different business purpose is concealed under the guise of a normal legal transaction, which may be contrary to the very existence of the transaction (absolute sham), or aimed at the performance of another different transaction (relative sham). What distinguishes a sham is the shared will by the parties to the transaction to conceal a specific unlawful reality.

Accordingly, the sham involves a desired and deliberately provoked discrepancy by the parties between its true will and what it externally manifests, for the purpose of creating a legal appearance concealing this will from third parties. Therefore, intrinsic to the sham is the existence of concealment, but since it is possible to imagine cases in which the concealment may be legitimate, the importance of the existence of a sham agreement between the parties to prove that there is a case of sham has been stressed. In other words, the parties are required to have the common desire to wilfully make declarations of a merely apparent nature to the extent that without the existence of such an agreement or common will, there could be no tax sham for legal purposes (ZORNOZA PEREZ). According to a sector of academic writers and courts this is even the key factor for differentiating between figures of sham (Article 16) and abuse of law (Article 15), meaning that a sham is a matter of fact, of proof of the existence of a sham agreement between the parties, whereas abuse is a matter of qualification, i.e. of interpretation, since transactions performed fraudulently involve a manipulation of cause, their use being for purposes of tax avoidance (PALAO TABOADA).

The distinction between both (general anti-avoidance rules) is of great importance in Spanish tax law because the effects of both figures are different for the taxpayers (cases of sham do not exclude the possibility of imposing penalties as in the case of abuse of law) as well as the procedures to follow in both cases.

Lastly, it is necessary to mention another anti-avoidance rule under Spanish tax law, which is less encompassing than those previously mentioned and on occasions appears in Spanish case-law associated with other “supplementary approaches”, such as the lifting of the veil doctrine. The rule included in Article13 of the Spanish General Tax Law sets forth the so called “principle of qualification”. In accordance with this general principle introduced into Spanish tax law, a transaction is defined by its true nature and not what the parties state or manifest. This principle must be understood to refer only the true legal nature of the act or transaction, and therefore, to expressly exclude the possibility of an economic approach by the tax administration or the courts as in the past. In recent years the Spanish High Court has pointed out that “an interpretation of tax rules based on the economic nature of the taxable income should be avoided” (Sentence of 11th May 2004).

11. Question: **Are there any other (alternative or supplementary) approaches established in practice or by case-law in this regard and *do these comply with the general principle of the division of burden of proof in your country*?**

Yes. Indeed in Spain, these general anti-abuse provisions coexist with certain supplementary approaches established by case-law, like the figure of indirect transaction, a sort of deviation from the general principle of law *substance over form*. This has been applied to complex business structures where it is difficult in many cases to judge whether a sham exists. These are many cases in which common law tradition has been combated through step transactions, and according to Spanish tax law they should be combat through the application of the general anti-avoidance rule of article 15 discussed above. The indirect business figure has often been used by the Spanish tax administration in preference to regulatory proceedings more consistent with this type of cases, such as abuse of law, since this allows for a greater degree of freedom when re-assessing the facts, without being bound by elements of fraud or sham such as cause or business purpose. The Spanish High Court has also confirmed the application of this alternative approach in various recent cases, in which the aforementioned approach is applied to complex business structures in which the joint use of several transactions is required to achieve the intended business purpose.

Another supplementary approach implemented in case-law is the lifting of the corporate veil doctrine for the purpose of trying cases of subjective sham in which the taxpayer acts through intermediaries. Several such incidents have been corrected using this technique in various case law judgments handed down by the Spanish tax courts, with clear preference over the figures of sham and abuse of law. This lifting the corporate veil doctrine, proper to the field of civil and commercial law is based on the principles of fairness and good faith. Therefore, it offers a wide margin to the tax administration to re-assess the position of the legal persons involved. The courts have also resorted to this type of supplementary approaches, combined on occasion with cases of sham.

The "Law for the Prevention of Tax Fraud", which entered into force on 1 December 2006 amended Article 43 of Spanish General Tax Law in order to introduce a new hypothesis of liability for the tax obligation of another person. The preamble of this law expressly points out that the law is based on the lifting of the corporate veil doctrine, and acknowledges that authorizing the administration to use it constitutes a novelty. In accordance with the two hypothesis established in letters g) and h) of Article 43, the persons liable for tax owed by a legal entity in specified circumstances are the individuals or entities with full or partial effective control of the entity either directly or indirectly. Those individuals or entities are also liable if a third individual or entity has control of both those individuals or entities and the liable entity. In both cases- as PALAO TABOADA has observed- *"the liability is subject to the requirement that proof be given that the legal entity was established or used in an abusive or fraudulent manner to avoid collection of the tax due and that there is unity of persons or economic spheres, confusion or diversion of patrimonies"*.

These sort of supplementary approaches have not failed to give rise to criticism to the extent that they pose a dangerous escape route with respect to the regulatory anti-abuse mechanisms provided under law and to the evidentiary requirements that these mechanisms involve. Generally, the use of this type of alternative approaches is advantageous to the Spanish tax administration given that such approaches are more flexible and easier to argue and demonstrate, meaning that they give rise to less technical disadvantages and less evidentiary difficulties than the general anti-avoidance rules of Articles 15 (General anti-fraud measure) and Article 16 (sham doctrine).

12. Question: **Are there special anti-abuse provisions dealing with the burden of proof in particular tax law areas and what exact requirements does the taxpayer have to fulfil? Is the required level of proof higher compared to the general provision or principle?**

Several examples could be mentioned here, in relation to various tax law areas.

Spanish Corporation Tax Law

In Spanish Corporation Tax Law there are mainly three provisions that could be considered to be special anti-avoidance rules: The exemption method to eliminate double taxation; the *Fiscal Transparency Regime* or *Controlled Foreign Corporation Legislation, (CFC Legislation),* in common law, and the anti *Thin Capitalization* rule.

The *Fiscal Transparency Regime* (*CFC Legislation)* is provided in Article 107 of Spanish Corporation Tax Law. This is the regime governing the tax treatment of the so-called "controlled foreign companies" and aims directly at the use of so-called "base companies", which are companies located in favourable or low taxation territories for the purpose of pooling income without paying tax on it in the state of residence of the end beneficiary. The special regime consists in the extension of the principle of taxation on worldwide income, through the inclusion in the taxable income of the resident entities in Spain, of certain income, i.e. passive income, obtained by foreign subsidiaries regardless of whether or not they have distributed the profit earned to their parents. Fiscal transparency applies only in respect of non-resident entities controlled by a resident and only in respect of certain income. Additionally, it takes into account the low level of taxation of the non-resident entity.

Regarding the first of these aspects relating to the subjective conditions of the application of the regime, i.e. control of the company subject to transparency, Article

107 provides that the regime will apply to non-residents in which the resident taxpayer alone or together with other related persons or entities, has an ownership interest equal to or greater than 50% of the capital, equity, profits or voting rights of the non-resident company in Spanish territory at the end of the latter company's reporting period. In relation to this requirement the issue of trust shares or income obtained by a non-resident entity is likely to be subject to international transparency. As discussed (DELGADO PACHECO), this gives rise to a problem of proving such a trust relationship, because the fiscal transparency regime is required to be applied to entities actually owned by a legal entity or person residing in Spain, although this ownership interest appears in the name of another physical person who is not the true owner or who is the true owner but through a trust under foreign law, where the resident is the beneficiary of this legal situation with certain defined rights.

In relation to the scope of application, the international fiscal transparency regime provided under Spanish law does not apply where the transparent entity resides in another member state of the European Union (Art. 107.15). However, for this purpose the burden of proof falls on the taxpayer, who must prove that the entity was established and operated for valid commercial reasons, and that the entity performs business activities, which implies an allocation of the burden of proof upon the taxpayer. The rule recently amended by Spanish law 4/2008, of 23 December solves the problem of applying the international regime to cases in which the non-resident entity resides in another member state of the European Union, shifting the burden of proof that the entity was established for valid commercial reasons on the taxpayer. The rule was amended to make the fiscal transparency regime compatible with EU law and ECJ's doctrine on the burden of proof on tax matters.

Thin Capitalization

Article 20 of *Spanish Corporation Tax Law* provides a rule for combating cases in which the external financing of the company obtained from related non-resident entities is higher than the amount that would be obtained in an arm's length transaction under normal market conditions. The aim is to avoid what is ultimately seen as a phenomenon of tax avoidance: The taxation of resident entities in Spain is reduced as a result of the debt owed to related companies. For this purpose, the rule prevents the deduction as an expense of interest borne as a result of a debt that the legislation considers to be excessive. The rule also governs the treatment of equity, whose payment in the form of dividends is not considered to be deductible.

The Spanish *Anti- Thin Capitalization* rule has the fundamental features of this type of rules, but also has a number of its own features whose evidentiary implications cast doubt on its compatibility with European Tax Law or bilateral conventions that follow the OECD Model. These features are as follows:

a) Spanish legislation builds the *Thin Capitalization* rule on a “set debt ratio” of 3 to 1. The rule refers this ratio to the net debt paid, which like tax capital, is taken to be its average over the tax period. This rule completely affects the rules on burden of proof, insofar as it frees the tax administration from proving that the company’s excessive debt is solely motivated by taxes, specifically to prevent taxpayers from unlawfully profiting from the evidentiary difficulties involved. The problem, for evidentiary purposes, is that it does not enable companies to prove that their debt is effectively a result of market conditions. Article 20.3 provides that taxpayers can submit a request to the tax administration for the application of a different ratio or coefficient, but this request must be made previous to the performance of the taxable event. Therefore, in the context of a tax audit, the entity can provide evidence that its debt ratio to the related company is the same as it would be under free market conditions.

b) The Spanish rule expressly refers to the indirect debt between a resident lender and a related non-resident company. Problems arise in relation to the concept of indirect debt. In this regard, the Spanish administrative doctrine has the extended the *Thin Capitalization* rule to the field of guarantees provided by related entities but it has made this criteria depend on rather high and uncertain proof requirements. The Spanish administration has agreed that the application of the limit provided by the thin capitalization rule requires proof that given the circumstances of the transaction, the non-guarantor is called upon to pay the loan or the lender would not have obtained guarantees allowing for such financing from an independent third party.

c) The *Thin Capitalization* rule is also applied where the lender resides in a country or territory classified as a tax haven. In this case, the resident entity may not submit a request to change the debt ratio.

d) Lastly, the thin capitalization rule is not applicable where the lender resides in another member state of the European Union.

The question is whether the entity, in the context of a tax audit, is able to provide evidence that its debt ratio to the related company is the same as it would be under free market conditions. In the opinion of the Spanish academic writers, it is precisely this inability to provide proof to the contrary that appears to implied under this law, which makes this Spanish thin capitalization rule inconsistent with the requirements arising from Art. 9 of the OECD Model Treaty. Consequently, many Spanish academic writers argue that the Spanish Thin Capitalization rule should be interpreted in a way that involves an *iuris tantum* presumption allowing for proof to the contrary. The question is when this proof to the contrary is to be provided considering that for the rule to truly respect the arm's length principle, the taxpayer should be able to provide this proof at any time, even after the performance of the taxable event within the framework of verification proceedings before the Administration. Obviously the burden of proof that the same level of debt would have been reached in an arm's length situation falls upon the taxpayer.

However, it is to the understanding of certain academic writers (SANZ GADEA) that the possibility provided in sec.3 of Art. 20, i.e. the taxpayer's ability to request an Advanced Pricing Agreement) from the administration allows for compliance with the arm's length principle), through the establishment of a new ratio.

In relation to court judgments concerning the burden of proof with regard to situations in which this *thin capitalization* clause is to be applied to taxpayers see answer to question no. 15 (case law).

Value Added Tax

Recently amended Article 87 of *Spanish Value Added Tax Law* has introduced a new provision aimed at combating "carousel fraud" in relation to VAT, which was directly inspired by the UK legislation. Like the UK legislation, the new provision establishes the liability of the acquirer "who should reasonably presume" that the input VAT charged by the supplier in the transaction or by any other supplier of the goods concerned has not been or will not be reported and paid. The liability imposed by the

Spanish law is, however, subsidiary, that is to say it will only be made effective if the supplier is found to be insolvent. It is deemed that the acquirer “should have reasonably presumed” those facts if the price payable by him is “notoriously anomalous”, due precisely to the omitted payment of the tax. The price could not be considered to be so if it is justified by economic factors other than the collection of tax. The tax administration bears the burden of proof that VAT was charged or should have been charged, but was not reported and paid.

It has been said that this provision does not meet the requirements of certainty and proportionality set forth by the ECJ, but in our opinion this question will probably depend on how the courts interpret the ambiguous terms of the law and the level of the proof required by to the taxpayer. In short, how the justification is interpreted is based on economic factors other than the collection of tax, and the taxpayer may oppose to the presumptions made. Essentially, the interpretation of the rule is not meant to involve an excessively difficult test causing the system to lead to a non-fault liability. .

Non- resident Income Tax Law

Spanish Non- Resident Income Tax Law also contains various special anti-abuse provisions. One such provision, dealing with the burden of proof, is included in Article 14.1.h) of the law. This Article which transposes the *Parent-Subsidiary Directive* into Spanish law, provides for the exemption from tax of the profits distributed by subsidiaries residing in Spanish territory to their parents residing in other EU members, where certain requirements are met. It also includes a special anti-abuse provision, and specifically an Anti Directive-Shopping measure by which the exemption is not applicable where the majority of the voting rights owed by the parent are direct or indirectly owned by individuals or legal entities that do not reside in member states of the European Union, unless the following is proven:

- The parent effectively performs a business activity directly relating to the subsidiary's activity, or
- The parent’s business purpose is to direct and manage the company's subsidiary by means of the appropriate organisation of material and personal resources, or
- The parent was established for valid commercial reasons and not to unduly enjoy the especial regime.

In accordance with the latter requirement, the questioned company must prove that it was established for “valid commercial reasons”, thus incorporating a kind of *business purpose test.* In this manner, the law reverses the burden of proof upon the taxpayer, which leads to two types of problems for evidentiary purposes (CALDERÓN CARRERO/RUIZ ALMENDRAL):

- The reversed burden of proof rests on a presumption of tax fraud which is built upon an objective fact, like that the latter parent company resides outside the EU, which itself is not necessarily indicative of tax evasion. In accordance with ECJ`s doctrine on tax abuse, only companies without a stable economic relationship with the state of establishment should be excluded from the benefits of the *Parent-Subsidiary Directive* (CALDERÓN/MARTÍN JIMENEZ). Therefore, in order for the reversal of this burden of proof to be compatible with EC law, it should be interpreted in this way. However, this is not what the Spanish Central Administrative Court has done, setting the level of proof so high that producing proof to the contrary is virtually impossible.
- The second problem is that in addition to requiring the taxpayer to prove that the company was established for “valid commercial reasons", it must also prove that it was not done to unduly enjoy the foreseen regime. This is a negative proof of events, *probatio diabólica*, which effectively set the requirements or the level of proof so high that producing proof is virtually impossible for the taxpayer. Once again, the correctness of the law depends to a great extent on how the tax administration and the courts interpret these evidentiary requirements to assure that the taxpayer always has the ability to prove any legal presumption of abuse to be false and to be able to show that its transactions were performed in good faith.

***13. Question:* Which body (tax authority, independent institution or tax court) may decide if the required level of proof is met? Are there different levels of proof that e.g. the tax authority or the taxpayer have to fulfill?**

In Spain, generally the decision regarding whether the required level of proof is met will be- at first instance- up to the tax authority. However, in the new figure of fraus legis adopted by Article 15 of *Spanish General Tax Law,* and discussed in depth above in answer to question no. 10, there is a special procedure for deciding whether certain arrangements have to be considered abusive by the Spanish tax administration. In short, before declaring abuse to exist, the tax administration must request a favourable report from the consultative committee. This report shall be binding for the Spanish tax administration. The general anti-abuse rule provided in Article 15 is drafted in such a manner that it requires the administration to demonstrate that the following three elements exist: a tax advantage, the use of an incorrect or inappropriate methods to achieve the aim pursued, and the lack of other purposes serving as grounds for the operation (business purpose test). So the tax administration principally bears the burden of proof that abuse has taken place. As for the proof to be given by the taxpayer to the contrary, an interpretation in accordance with EC law shall place the burden of proof on the economic substance test. So the taxpayer is required to prove both potential economic profit and a subjective business purpose. However, that does not mean a different level of proof is to be imposed on the taxpayer, as the Spanish rule seems to also impose a high standard on the level of the burden of proof imposed on the tax administration.

14. Question: **Is the decision of the above authority or body subject to a full (or a partial) judicial review and are there different levels of burden of proof in the different stages of the judicial proceedings?**

In answer to this question, under Spanish law it is essential to take into account that the two previously discussed general anti-avoidance rules provided in Article 15 and 16 are of a different nature and lead to different consequences based on the related penalties imposed. In cases of fraud or abuse (Art. 15) penalties are not imposed, whereas in cases of sham (Art. 16) they are. The anti- fraud or abuse rule (Art.15) poses a problem of interpretation, whereas the, anti-sham rule (Art. 16) is a matter of fact and therefore essentially involves proof of the existence of a sham. In the Spanish system of judicial review, matters of fact are subject to the court's discretion and only very exceptionally may be reviewed on appeal by the Supreme Court. This court may only come to judge the proof assessed by the court of first instance where it is alleged that this judgment was made arbitrarily or in violation of general principles of law or general rules on the evaluation of evidence, which is quite difficult. Therefore, if the tax administration bases its argument on the figure sham, the High Court may not challenge this classification because, generally, it may not reassess proof that has already been examined. If the case is tried as a case of fraud or abuse of law, being that this is a matter of interpretation, the High Court may reconsider the finding of abuse of law. Therefore, in Spain it is more common for cases to be argued by the tax administration as a case of a sham (Art. 16).

***15. Question:* Are there any court judgments in your jurisdiction concerning the burden of proof with regard to:**

a) situations in which (special) anti-abuse provisions may be applied to the taxpayer?

Yes. An example is the decision handed down by the Spanish Central Administrative Court on the15th of October 2004, in a very controversial case that had to do with the application of the especial anti-avoidance clause of Art. 14.1. h) of Spanish Non- Resident Income Tax Law, which was discussed above in answer to question no. 12. In this decision the administrative tax court interpreted the anti-abuse clause of Art. 14.1. h) in a way that has been criticised by academic writers for being too strict and inappropriate for its purpose, since it is interpreted that the three *safe harbours* provided in the rule must be cumulative and not alternative. As it has been pointed out, this interpretation would ultimately exclude from the Parent-Subsidiary Directive a large number of cases relating to dividends paid by Spanish companies to companies located in the European Union but controlled by non-residents in the EU. (CALDERÓN CARRERO/RUIZ ALMENDRAL):

b) requirements that may be imposed on the taxpayer?

In this decision handed down by the Central Administrative Court of 15th of October 2004, the requirements imposed on the taxpayer to escape from the special anti-abuse provision seem effectively very high. In this decision, the administrative court parent companies whose shares are owned by individuals or legal entities that do not reside in member states of the EU to prove the following three circumstances in order to avail themselves of the benefits of the *Parent-Subsidiary Directive*: they conduct a business activity directly relating to the business activity carried on by the subsidiary; their business purpose is to direct and manage the subsidiary; and the company was established for valid commercial reasons and not to unduly avail itself of the exemption between parents and subsidiaries provided under law.

Also a number of judgments handed down by the Spanish Courts can be highlighted in relation to the requirements which can be imposed on taxpayers in situations in which the special anti-abuse provision of Article 20 of Spanish Corporation Tax Law (*Thin capitalization)* is to be applied. As has been previously explained (see answer to question no. 12, special anti-abuse provisions), the main issue relating to the Spanish anti- *thin capitalization* rule is whether or not it allows for proof to the contrary by the taxpayer in accordance with the arm's length principle. In other words, it must allow the borrower to prove that the debt agreed upon is the same that would have been obtained at arm's length, which would exclude the application of the thin capitalization rule. According to certain of the judgments handed down by the Spanish court., it must be understood that for the Spanish thin capitalization rule to be consistent with the requirements arising from the arm's length principle, regardless of the debt ratio, it should be the administration which proves that the debt arranged could not have been agreed upon at arm's length. (Judgment of *Audiencia Nacional* dated 15th January 2004; Judgments of *Tribunal Superior Justicia Madrid* dated 15th October 2003 and 28th March 2008).

c) the compatibility of burden-of-proof provisions in anti-abuse matters with your country's Constitution or EU law?

In Spanish case law, judgments have been handed down in relation to the *burden-of-proof provisions in anti-abuse matters, mainly interpreting our general anti-abuse clauses (Articles 15 and 16 of Spanish General Tax Law*). The *Spanish Constitutional Court* has handed down certain relevant decisions relating to the distinction between the figures of fraud/abuse and sham. In Sentence 120/2005, 10th of May, it ruled that the requirement of foreseeability of a criminal conviction for tax purposes is not satisfied in those cases in which this sentence is handed down on the grounds of conduct classified as tax law fraud. Therefore contrary to Spanish Constitutional law, case law offers the possibility of imposing penalties on fraud cases. Whereas in cases in which *sham* has been found to exist, if the performance of a sham transaction is proven, a conviction for tax fraud is admissible, according to *Spanish Constitutional Court* (see Sentence 48/2006, 13th February). Much more ambiguous, however, was the judgment handed down by the *Spanish Constitutional Court* in Sentence 128/2008, of 27th October, in which it ruled that tax evasion *"may come to involve the use of legal figures for reasons other than their intended purpose and result in avoidance of tax"*.

PART. C: THE BURDEN OF PROOF AND EUROPEAN TAX LAW

16. *Question:* EC law and the reversal of the burden of proof.

1) **Could you give an impression how the Leur-Bloem judgment was viewed in your country by lawyers, the judiciary and the government?**

The main criticism of the *Leur-Bloem* judgment by Spanish academic writers is that the scope of the *Merger Directive* was interpreted in a very strict manner and might prevent member states from establishing conditions or additional requirements to prevent abuse of the Directive which are in line with the interpretation of the anti-abuse rule contained in Article 11 of the *Merger Directive* for the following reasons. Firstly, it restricts the internal anti-abuse law which can be applied in compliance with the Directive. Only laws respecting *business purpose* shall be consistent with the Directive. Secondly, member states cannot refuse to apply the Directive where the transaction has as its principal objective or as one of its principal objectives, tax evasion or tax avoidance, but rather where it's sole purpose or objective is fraudulent or evasive. Thirdly, the states may not refuse to fully or partially apply the provisions of the Directive, but rather solely the application to its profits following a comprehensive case by case analysis of its transactions.

In Spain, discussion by academic writers has arisen in relation to the Spanish law which establishes conditions for the application of the special system of taxation provided in Chapter VIII of the *Spanish Corporation Tax Law* to mergers, divisions, transfers of assets, exchanges of securities and the change of the registered office of a European company or a European cooperative company of a member state to another in the EU. This is the Spanish law transposing the anti-abuse clause of the Merger Directive 90/434/EEC, which is now Article 96.2 of the *Spanish Corporation Tax Law*.

The aforementioned clause requires the existence of “valid commercial reasons” for corporate restructuring operations to be able to avail themselves of the special system of taxation and excludes its application where such operations were performed solely to obtain a tax advantage. Among lawyers and professors, this anti-abuse clause was interpreted in two different ways, which involve two different interpretations of the Leur Bloem judgment:

A) In the opinion of one sector of writers, two requirements must be met for the Spanish anti-abuse clause to be applicable: 1) the operation is not carried out for valid commercial reasons, such as the restructuring or rationalisation of the activities and 2) that the operation is performed for the sole purpose of obtaining a tax advantage (Autonomy thesis). Both conditions must be met because they are independent from each other. In accordance with this position, the administration must show double proof in order to refuse to apply the special system of taxation to a business restructuring operation: proof that there are no valid commercial reasons for the operation and proof that fraud or tax evasion exists.
B) According to another sector of writers, the Spanish anti-abuse clause may only be applied in the case of fraud or tax evasion. Therefore, if there is no “valid commercial reason” for a certain operation, it should be understood that there is an *iuris tantum* presumption of the existence of fraud or tax evasion, which may be rebutted. This means that despite the absence, *prima facie*, of valid commercial reasons, counterproof can be provided to show that the objective of the operation is not fraud or tax evasion. This is a possibility, which from this second standpoint, would not be excluded by the *Leur Bloem* judgment.

Generally, the Spanish Central Administrative Court has interpreted the Spanish special abuse clause in the light of the Leur Bloem judgment on several occasions (Judgments handed down on 15 June 2006 and 27 September 2007) as a presumption allowing for proof to the contrary to be provided, which has led to the exclusion of the application of the special system of taxation for corporate reorganisations to cases where the taxpayer has failed to prove that there were valid commercial reasons for the transaction. This involves an allocation of the burden of proof upon the taxpayer over the existence of a business purpose.

2) Did the decision lead to any significant changes in legislation?

No.

3) Are there provisions in the national tax legislation that do not yet meet the standards in the Leur-Bloem judgment?

The measure under Spanish law which could lead to a result contrary to the objective and scope of the Directive 90/434/CEE, *Merger Directive,* as it has been interpreted by the ECJ in the *Leur-Bloem* judgment, is the specific measure provided as a transposition of Article 11.1.a) of the Directive, which is now Article 96 of *Spanish Corporation Tax Law.* This measure establishes the conditions for the application of the special system of taxation provided in Chapter VIII of the law on mergers, divisions, transfers of assets, exchanges of securities and the change of registered office of a European company or European cooperative company of one member state to another member state in the EU. According to Sec. 2 of Article 92 this special system of taxation shall not be applied *where the transaction performed has as its principal objective fraud or tax evasion. Specifically, the system of taxation shall not be applicable where the transaction is not performed for valid commercial reasons such as the restructuring or rationalisation of the activities of the entities participating in the operation but rather for the sole purpose of obtaining a tax advantage.*

In relation to this law, certain academic writers (GARCÍA PRATS) have pointed out that the wording of the law does not adapt to the interpretation of the *Merger Directive* made by the ECJ or the scope of the authorisation granted to the member states by the ECJ within the scope of the Directive. Firstly, as pointed out by GARCIA PRATS, the Spanish law applies a general measure to cases where there are no valid commercial reasons which appear to exclude a subsequent analysis and seem to allow for the automatic denial of the benefits of the Directive. However, as Spanish academic writers have generally pointed out (FALCÓN TELLA), this special anti-abuse clause of Art. 96.2 of *Spanish Corporation Tax Law* shall only be in accordance with the text of the Directive if it is interpreted in the sense of a mere presumption, allowing for proof to the contrary, as it has generally been interpreted by the Spanish administrative doctrine in accordance with the *Leur Bloem* judgment.

This implies that the taxpayer bears the burden of proof of a valid commercial reason rather than solely a tax-related purpose, without shifting the burden of proof away from the tax administration, which must prove that there is an objective or fraud or tax evasion.

However, as stated by professor PALAO, the origin of the expression “valid commercial reasons” in the doctrine of the *business purpose test* links the testing of its presence in a certain transaction to whether or not its objective is *tax avoidance.* In this manner the legal proceedings relating to determining whether or not there are “valid commercial reasons” are confused with proceedings to classify the transaction as abusive or fraudulent. Therefore, it is possible to distinguish between two levels of verification of the existence of valid commercial reasons. An initial level, in which the absence of these grounds shall be prima facie evidence or presumption of fraud, and a second level, in which if the taxpayer objects to the presumption, it shall be necessary for the Administration to determine (test) whether the transaction is fraudulent (abusive). If the measure provided in Article 96.2of Spanish *Corporation Law* is interpreted in this way, its consistency with EC law and the ECJ´s doctrine in the *Leur Bloem* judgment is guaranteed.

As for the analysis of the transaction from the standpoint of the *business purpose test*, the Spanish Administration, for example, has considered a valid commercial reason to exist where an attempt is made to make the company’s business structure more flexible so it can undertake new business strategies (DGT 13-07-00, Query V0061-00). This is also true where the objective of the transaction consists in the rationalisation of business activities (DGT 7-5-01, Query V0024-01).

Secondly, it was pointed out that the measure provided in Article 96.2 of *Spanish Corporation Tax Law* is not in line with the ECJ’s interpretation of the *Merger Directive* by means of the *Leur Bloem* judgment given that the measure does not meet the community’s proportionality requirements since it gives the administration the power to determine whether a commercial reason exists. Therefore, the Administration has the power to *refuse to apply the special system of taxation to corporate restructuring transactions when the company is found to be* *pursuing a tax advantage other those arising from the deferral system of taxation* (GARCÍA NOVOA).

However, we believe the proportionality of the Spanish anti-abuse measure shall arise as a result of the manner in which it was applied to this specific case, which is also in accordance with ECJ's doctrine in the *Leur Bloem* judgment. Accordingly, the proportionality of the measure is salvaged as long as the taxpayers are able to prove by means of objective tests and without bearing excessive administrative difficulties that the transaction performed is not abusive because it has a business purpose or relevant legal or economic effects.

17. *Question: (reversal of the burden of proof and time limits)* Does the tax legislation of your country contain similar provisions and how do you assess such a provision in the light of EU (tax) law?

No, in Spain the merger regime does not provide a similar rule, since it is applied automatically. As for the burden of proof of the lack of valid commercial reasons or the abusive objective of the transaction, which generally falls on the Administration, see answer to question no. 16.

18. (Reversal of the burden of proof and transactions with non-domestic entities) *Question:* Does your national tax legislation contain a more or less similar provision and what is your opinion of the provision in the light of EU law requirements?

Article 21.1.b) of Spanish Corporation Tax Law contains a more or less similar provision, though related to tax havens in the EU. This Article provides for the exemption of dividends and income from a foreign source arising from the transfer of securities representing the equity of non-resident entities in Spanish territory. According to Article 21.1.b), in no case shall the provisions of this Article be applied where the investee is a resident in a country or territory classified as a tax haven, unless it resides in a EU member state and the taxpayer provides proof that there are valid commercial reasons for its establishment and operations and that it carries out business activities. Here there is a reversal of the burden of proof upon the taxpayer. Specifically, the reversal of the burden of proof is the way in which the special anti-avoidance rule is being built.

19 Question: **How do you view the taxpayer's obligation to provide the requested proof (as held by the ECJ) and when does a reasonable division of the burden proof evolve into a situation in which, after the taxpayer provides the initial proof, the burden shifts to the tax administration to prove the nature of the activities of the foreign charitable institution?**

The starting point adopted by the ECJ in the *Persche Case* in relation to the burden of proof of the taxpayer in this type of cases appears to be appropriate. In principle, the taxpayer has the burden to prove that it meets the conditions or requirements provided under law to enjoy a tax advantage or credit, and accordingly, member states have the right to apply the requirements for deductibility in accordance with the general criteria of distribution of the burden of proof, so that the deduction is applied on the basis of proof provided by the taxpayer. Effectively, this general criterion relates to a reasonable division of the burden of proof between the tax administration and taxpayers. However, from my point of view, there is a turning point from which this reasonable division of the burden proof evolves into a situation in which, after the taxpayer provides the initial proof, the burden shifts to the tax administration to prove the nature of the activities of the foreign charitable institution. This inflection point may come marked in cases such as the *Hein Persche* case by the fact that the taxpayer fulfilled its duty of cooperation to collect the evidence required but was unable to comply with the evidentiary standard required by the internal law. This is especially true in cross-border situations in which the proof requested for the tax concessions does not come directly from the taxpayer from which it is requested, but rather from a third party established in another member state. In such cases, its seems reasonable to modulate the strict consequences of sharing the burden of proof by not holding the taxpayer responsible for the failure to obtain proof and taking into account the possibilities the administrative authorities have to verify the proof provided by taxpayers making use of the information exchange mechanisms provided in Directive 77/799/CEE. Definitively, the fact that there are legal channels for the exchange of information between states such as those provided in Directive 77/799/EEC also introduces a parameter by which to reflect on the proportionality of the burden of proof to be assumed by both parties. The administrative authorities can and are required to avail themselves of opportunities for mutual assistance provided by Directive 77/799 to verify cross-border transactions. Also, the evidence or cooperation that may be required of the taxpayer in cross-border transactions may not be disproportionate, in accordance with the interpretation made by the ECJ in the cases *Vestergaard (C-55/98, 1999), Danner (c-136/00, 2002)* o *Centro di Musicologia Walter Staufer (C-386/04, 2006).*

In accordance with the above, from the viewpoint of maximizing EC freedom, the ECJ could have concluded that in this case of difficulty in obtaining evidence by the taxpayer, the State in which the deduction is to be recognised should be required to obtain this proof from another state in which the donation was made. However, it is true that the ECJ`s judgment on this case is more in accordance with the literal wording of Directive 77/799/CEE.

The burden of proof and proportionality

20. Question: **To what extent is the direct tax legislation and case law in your country in line with the above-mentioned standards set by the ECJ?**

From the standpoint of the standards established by the Community courts to assess the consistency with EC Law of the special anti-abuse clauses of the member states, various Spanish anti-abuse rules have been or are still being questioned.

Following the ECJ` judgment in the *Lankhorst case*, the Spanish rule on *Thin Capitalization and Controlled Foreign Corporation Legislation*, was amended in a manner considered by Spanish academic writers to be an excessive reaction of the Spanish legislation to EC doctrine, considering that following Law 62/2003, the application of both system of taxations to companies residing in a tax haven was excluded, except where the residence is in a tax haven. This, for example, has led the Spanish rules on Thin Capitalization to be meaningless, where it would have been enough to add a clause to Article 20 of Spanish Corporation Tax Law enabling the Spanish tax administration to apply the rule where the EC financing transaction is considered to be artificial and instead exclude its application to thin capitalization in situations in which a valid commercial reason can be found (MARTÍN JIMÉNEZ).

However, the solution adopted was not to apply the Spanish law where the lender resides in another state of the European Union.

Other Spanish laws which may lead to difficulties of consistency with EC law in accordance with these proportionality standards are as follows:

Article 9.3 of *Spanish Income Tax Law*, to the extent that it establishes a sort of extension of the Spanish tax jurisdiction in the event the taxpayer moves his residence to a tax haven, which does not allow for rebuttals with respect to the commercial reasons for the change in residence. In other words, the Spanish law does not allow any distinction to be made between taxpayers who move for legitimate reasons and those who do so for artificial reasons of avoidance or abuse. The same is true of other Spanish laws which seek to hinder or restrict relations between Spain and other EC tax havens to the extent that it can be understood that they are also applicable to non-artificial transactions (CALDERON CARRERO/MARTÍN JIMENEZ).

However, the measure which gives rise to most doubts in this connection is provided in Article 16 of *Spanish Corporation Tax Law,* with respect to related transactions. This measure requires taxpayers to assess the transactions they perform with related entities (intercompany prices) at their market price, i.e. the price that would have been agreed upon by independent parties under comparable circumstances, that is to say, to justify that transfer pricing is at arm’s length. The problem is that the Spanish law is founded mainly on *outcome testing* of taxpayer transactions whose consistency with the ECJ`s jurisprudence and OECD Guidelines on Transfer Prices is questionable. To the extent that transfer pricing is based on valid commercial reasons which the taxpayer can explain, the adjustments that the administration intends to pursue with subsequent objective data should be discarded.

Additionally, the taxpayer must prepare extensive documentation enabling it to justify this price and this documentation is required to be made available to the tax administration. The breach of any of the requirements provided under the law involves a severe penalty system, regardless of the domestic or international scope of the transaction and whether the harm to the Tax Department is greater or lesser. Therefore, the law would have difficulties resisting a EC consistency test from the standpoint of the proportionality of the burdens of documentation and proof imposed on the taxpayers, particularly given that the OECD guidelines stress that the tax authorities should take great care to assure that the imposition of documentation requirements will not impose disproportionately high costs and administrative burdens on multinational enterprises.

PART. D. BURDEN OF PROOF IN CROSS-BORDER SITUATIONS (International Tax Law)

Transfer Pricing Aspects

The burden of proof between tax authorities and taxpayers

***21. Question*: Who bears the burden, the tax administration or the taxpayer, of proving that transfer pricing operations are at arm's length?**

Since according to the recently reformed Article 16 of *Spanish Corporation Tax Law,* the rule on transfer pricing operations is that the taxpayer must price relate party transactions (intercompany operations) at normal market value, there is an obligation to the taxpayer. At the same time, it requires the taxpayer to prepare and make certain documentation available to the Administration so that it can verify and check whether market prices have effectively been applied in its related-party transactions. Article 16 also contains a description of market price: "the price that would have been agreed upon by independent individuals and entities at arm's length". This means that in possible verification proceedings, the taxpayer must be able to justify the prices declared as being market prices in accordance with the documentation required to be kept and shown to the Administration. From my standpoint, this involves the fulfilment of a duty for the taxpayer, not a burden in the original sense of the term (private law). Additionally, the failure to provide or the inadequate provision of documentation by the taxpayer is deemed to be a tax violation, evidencing that this is the fulfilment of a duty.

Where the tax administration finds that there is a difference between the price agreed upon by the taxpayers and the market price, the corresponding assessment-secondary assessment-must be made, regulating the fiscal consequences of a possible difference between both values. Due to the application of the general rules regarding the burden of proof under *Spanish Tax Law*, in principle, the tax administration bears the burden of proving that the transfer pricing is not at arm's length. In this connection, for example, the judgment of the High Court of Madrid dated 28 March 2008, sided with the appellant because it was to its understanding that the tax administration's inspection authorities failed to show that the level of debt does not relate to the debt acquired as a consequence of independence (it was a case of *thin capitalization).*

However, since this involves the testing of a negative fact (that transfer pricing is not at arm's length), Spanish law provides a secondary and automatic adjustment form which shifts the burden of proof of this negative fact, and therefore it is not necessary for the Administration to prove that there was an avoidance objective or purpose.

However, sec. 3 of Article 21 bis of *Spanish Corporation Tax Law*, exempts taxpayers from making this adjustment where in view of the purpose and/or features of this transaction, such an adjustment makes no sense. Accordingly, this is an implicit reversal of the burden of proof upon the taxpayers, but the problem lies in the fact this Article does specify the burden of proof to be borne by the taxpayer to exclude this secondary effect. One interpretation of this law in accordance with the ECJ`s case law, is that the taxpayer should be excluded from applying this legislation if he provides proof that his conduct is valid from a commercial standpoint, regardless of whether the price is other than the price paid at arm's length.. This means an allocation of the burden of proof upon the taxpayer, under the provision of Art.21.bis.3 of *Spanish Corporation Tax Law*, but the question still remains, is it enough to preserve the taxpayer's right to prove commercial reasons?

***22. Question*: Is there a statutory requirement in the national tax legislation to prepare documentation proving the arm's length value in the determination of transfer pricing? Is the breach of the rule accompanied by an administrative or criminal penalty? Are "*statutory requirements*" provided or is the "*documentation just recommended to avoid shifting the burden of proof concerning a reasonable price to the taxpayer*"?**

Yes, there is statutory requirement. For the first time in the Spanish transfer pricing legislation, Law 36/2006 provides for the obligation of taxpayers to properly document their transactions with related parties, in line with the requirements proposed by the EU Joint Transfer Pricing Forum. The documentation requirements are laid down in Arts.

18-20 of the *Spanish Corporation Tax regulations* and are applicable since 19 February 2009.

Several types of transactions will not be subject to the general documentation requirements, namely:

- transactions between companies integrated in a tax consolidation group;
- transactions between an economic interest grouping and a joint venture and its members; and
- transactions carried out in the context of a takeover bid or a public stock offering.

Transactions carried out by taxpayers benefiting from the small and medium-sized companies regime or by individuals are also excluded from the general documentation obligations, but are nevertheless subject to specific requirements.

Additionally, Spanish entities involved in transactions with tax residents of tax haven jurisdictions (determined as such for Spanish purposes) must identify the entities (and their directors) or individuals involved in such transactions, as part of their documentation obligations.

As a consequence of the statutory requirements provided by Spanish Corporation Tax Regulations**,** it is the taxpayer that must value the related-party transactions on an arm's length basis, consistent with the documents reflecting the group's transfer pricing policy. So the burden of proof rests with the taxpayer.

***23. Question*: If there is a statutory requirement to prepare documents, what is the nature (administrative or criminal) of the related penalty?**

Law 36/2006 provides for a specific penalty system that will be applicable 3 months after the *Corporation Tax Regulations* have entered into force, which is 19 February 2009. In this regard, failure to comply with the documentation requirements constitutes a tax violation that is subject to penalties. These are administrative penalties and are determined as follows:

- if the tax authorities do not modify the taxpayer's valuation, the penalty consists of a fixed amount of EUR 1,500 per item and EUR 15,000 per group of items with regard to each one of the documentation requirements that is not complied with or which is improperly complied with, under the Corporation Tax Regulations; and

- if the tax authorities modify the taxpayer's valuation, the penalty is 15% of the amounts resulting from any corrections made, with a minimum penalty of EUR 3,000 for each item or EUR 30,000 per group of items.

No penalty will be imposed, even if the taxpayer's valuation is modified, when the taxpayer has followed the documentation requirements and has valued a transaction based on the transfer price derived from such documentation.

***24. Question*: Is the taxpayer required to provide only "original documents" or must it provide even a functional analysis with an evaluation? In particular, are there implicit limitations in the request for information by domestic tax authorities to foreign companies within the same group of the audited company? (For example: during the tax audit, does the taxpayer have to provide the price that its foreign affiliates paid to independent enterprise or should the tax administration consult the competent foreign tax authorities by means of information exchange?)**

The required documentation can be classified into two categories, namely documentation relating to the group to which the taxpayer belongs (a) and documentation relating to the taxpayer itself (b)

(a) Documentation relating to the group

This documentation includes the following:

(1) general description of the organizational, legal and transactional structure of the group;

(2) identification of the related companies involved in intra-group transactions;

(3) general description of the nature, amounts and flows of the intra-group transactions;

(4) general description of the functions performed and risks assumed by the related entities affecting, directly or indirectly, the transactions carried out by the taxpayer;

(5) details regarding the ownership of patents, trademarks and other intangible assets;

(6) description of the transfer pricing policy followed by the group that indicates

compliance with the arm's length principle;

(7) details regarding any cost sharing agreements and service agreements within the group;

(8) details regarding any Advanced Pricing Agreement or analogous procedures involving the group; and

(9) annual report of the group (or the equivalent thereof).

These requirements are not applicable to those groups benefiting from the SME regime (i.e. with a turnover of less than EUR 8 million).

(b) Documentation relating to the taxpayer itself

This documentation includes the following:

(1) name and surname or corporate name, tax domicile and tax number of the taxpayer, a detailed description of the relevant intra-group transactions and their amounts;

(2) comparability analysis under Art. 16(2) of the Corporate Income Tax Regulations

(3) valuation methods chosen, the implementation thereof and the resulting value or range of values;

(4) criteria for the distribution of jointly rendered services in favour of other related parties and any services and/or cost sharing agreements related thereto; and

(5) any other relevant information and shareholder agreements.

If transactions carried out by a taxpayer are linked or continuously performed such that they cannot be properly valued independently, the mentioned documentation must cover the totality of these transactions.

In addition to these documentation requirements provided under Art. 16 of the *Corporation Tax Law*, there is a general obligation to provide information to the tax authorities established in Art. 93 of *Spanish General Tax Law* that extends to any person, natural o legal, public or private, that has relevant tax information due to its economic, professional or financial relationship with other persons. "Tax relevant information" has mainly been interpreted as any information that can, directly or indirectly, assist the tax authorities in determining whether a party has satisfied the obligation to sustain public expenses based on that person`s economic capacity established under Art. 31.1 of the Spanish Constitution.

As for the question regarding whether there are implicit limitations in the request for information by domestic tax authorities to foreign companies within the same group of the audited company, it can only be said that Spanish regulations only provide some limits on the general obligation to provide information established by Art. 93 of *Spanish General Tax Law*. These limits mean that information may be denied to the tax authorities if related to the following:

- correspondence or other forms of confidential communication, unless a judicial ruling has been issued demanding such information;
- the secrecy of information given to other Spanish authorities for statistical purposes only;
- the secrecy of notarial documents that refer to wills, codicils, recognition of paternity acts and marital issues, with the exception of information about the financial condition and property of the marital estate;
- the professional secrecy related to private non-financial information that unofficial professionals may know because of their professional activities, if the revelation of such information would violate the personal privacy or injure the reputation of the individual;
- the obligation to keep as confidential the information that has been revealed to lawyers, consultants, attorneys, etc. as a consequence of the nature of their services. This exception does not apply to the identity of the client, the amount paid for the services received or any other information derived from any economic relation between a professional and his or her client; and
- the professional confidentiality to be maintained when professionally exercising the freedom of press or the right of the individual to receive information contained in the Constitution.

But Spanish regulations remain silent on the question regarding what happens when the taxpayer does not obtain the documentation fromthe group, after having requested it. In those cases, independently of whether the group is a resident or non resident, it is not clear in our legislation whether it is the tax administration that must request this information from the group by means of the bilateral conventions aimed at avoiding double taxation or by means of a prior recourse to an exchange of information procedure.

25. *Question:* Is there a regulatory hierarchy in choosing these methods? Are the transactional methods preferred over the profit-based methods? Is the choice based on the nature of the goods or service sold?

Article 16.4 of *Spanish Corporation Tax Law*, as amended by Law 36/2006, defines the following valuation methods for determining market price, which are closely in line with the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations:

- *Comparable uncontrolled price method*

- C*ost plus method*

- *Resale price method*

At present, as compared to the previous regulations which prioritized the implementation of the first of the methods listed and treated the other two as merely supplementary, the current regulations place these three methods on the same level, this being in full compliance with OECD Guidelines.

When the aforementioned methods cannot be applied in view of the complexity or the information concerning the operations, it is possible to apply the Overall Profit Allocation Method, and the Economic Sector Gross Margin Method.

As can be observed, the internal regulations contain the same methods as the OECD Guidelines, respecting the hierarchy provided in the OECD Guidelines to the extent that the transactional profit methods are the last-resort methods, e.g, they should be used only in the exceptional situations where there are no data available or the available data are not of sufficient quality to rely solely or at all on the traditional transaction methods.

However, Article 16.4 does not stipulate when to apply each of the methods or which kind of transactions are better suited to one or another transaction. Royal Decree 179372008, which has amended the Spanish Corporation Tax regulations is not at all explicit in its instructions regarding the application of the different methods. However, Article 16.5 provides that: *the comparability analysis and information on comparable transactions are the factors that determine the most appropriate valuation method in each case*. Accordingly, some Spanish academic writers have made the following conclusions:

- Spanish legislation seeks to have the most appropriate valuation method chosen in each case, closely in line with the "best method rule", and requires the taxpayer to choose the method which is most in accordance with the arm's length principle based on the circumstances in each case.
- Spanish legislation establishes a strong link between comparability analysis and method selection, but gives no indications, making it necessary to interpret the rules in light of the Guidelines and the recent draft amendment of the Transfer Pricing Guidelines.
- Spanish legislation stresses the importance of information available to choose the most appropriate method.

***26. Question*: Given that Article 9 of the OECD Model is silent on the subject of the burden of proof, are there bilateral conventions to avoid double taxation that instead contain express provisions on the burden of proof in transfer pricing matters? Is this a matter of domestic law?**

There are no bilateral conventions containing provisions in this sense.

Of the tax treaties signed by Spain to date, only 27 contain a clause similar to that of Art. 9(2) of the OECD Model Convention regarding the application of corresponding adjustments, namely the tax treaties with Algeria, Argentina, Australia, Belgium, Bolivia, Canada, Croatia, Cuba, the Czech Republic, Denmark, Estonia, France, Greece, Iceland, Ireland, Israel, Lithuania, Macedonia, the Philippines, Poland, Portugal, Romania, Russia, the Slovak Republic, Slovenia, Sweden, Turkey, Venezuela, the

United States and Vietnam. However, the tax treaties with Belgium, Chile, France and Portugal include a clause equivalent to Art. 9(2) of the OECD Model Convention, with the caution of expressly stating that they will make the adjustment only if this is justified, thereby expressing their reservation.

The treaties with Belgium, Canada, Italy, the Philippines, Portugal and Romania establish a 2-year period to initiate a request for the mutual agreement procedure, beginning on the date on which the assessment regarded by the taxpayer to be contrary to the treaty provisions was made. The treaties with Algeria, Argentina, Australia, China, Croatia, Ecuador, Estonia, India, Korea (Rep.), Luxembourg, Macedonia, Mexico, Poland, Sweden, the former USSR and Vietnam establish a 3-year period.

***27. Question*: Does the national law in your country require prior recourse to an exchange of information procedure in order to finalize a tax assessment regarding transfer pricing or a tax assessment involving international tax issues in general?**

No there are no explicit provisions on this matter.

Spain has raised the issue of offshore information requirements in cases in which the tax administration has to request data or documents located abroad from the taxpayer. In all such scenarios, the question has been raised as to whether to request the data from the taxpayer who theoretically has them under his control, or if conversely, such information should be required under a double taxation treaty between the two States. Initially, in a judgment dated 23 December 1994, the Spanish Central Administrative Court ruled that any request for information issued by the Spanish inspection authorities referring to date held by individuals or permanent establishments abroad must be substantiated under the information exchange clause of the applicable double taxation treaty rather than on the basis of Spanish domestic law. However, subsequently in a judgement handed down on 11th February 1999, the Spanish Central Administrative Court supported allowing the Spanish tax administration to require the central offices of a resident financial institution data on third parties held by a subsidiary located in a country with which Spain has entered into a double taxation treaty.

- **In particular, are the tax authorities free to issue assessments based on alleged violations of the arm’s length principle without the necessity of**

previously verifying abroad the information and the data which could confirm or void such assessments?

Spanish legislation does not establish any provisions in this regard. However, an interpretation of the rules regarding related party transactions in accordance with ECJ`s case law (*Lankhorst c*ase, *Test Claimants in the Thin Cap Group* case or *SGI* case) should lead to a negative answer to this question. Just as in case law, the legislation should not be able to be applied to cases where the taxpayer proves that a related party transaction was carried out for business or commercial reasons, the tax administration should not make its adjustments on the basis of an alleged violation of the arm`s length principle, which has not been sufficiently verified. This is because a comprehensive interpretation of the ECJ`s case law shows that the proof of incompliance with the arm's length principle for valid commercial reasons should not only extend to the secondary assessment, but also to the first and correlative assessments. Conversely, the Administration should first check the information and the data which could confirm such assessments.

- What kind of obligations does the taxpayer have to fulfil if the tax authorities request further information during this procedure?

On this particular, see answer to question no. 24.

***28. Question*: What is the taxpayer's legal position in a mutual agreement procedure?**

The current opinion of academic writers is that according to Art. 3 of the Mutual Agreement Procedure Regulation (MAPR), recently regulated by Royal Decree 1794/2008 of 3 November, the taxpayer has a subordinate position in the MAP. Some academic writers have also pointed out that the taxpayer is not part of the procedure, although other authors (MARTIN JIMENEZ) have pointed out that the fact that the procedure takes place between two States does not imply that the concerned taxpayer is kept totally aside, even if only for a practical reason: the success of the procedure depends on the taxpayer's acceptance.

According to Art.1.1 of the MAPR the taxpayer has the duty to provide the tax administration with every fact and all the information and evidence needed to resolve the case. This information must be complete and accurate and must be timely supplied to the requesting authority. Among Spanish academic writers, it has been considered (PALAO TABOADA) that the relationship between the administration and the taxpayer is not one of opposition but one of collaboration: the taxpayer will supply the administration with any information that will help it uphold his case in his own interest, including before the other state's administration.

Art.3.2 MAPR grants the taxpayer the following rights:

- The right to initiate the procedure
- The right to be informed of the state of the procedure
- The right to appear before the tax administration to present his case