

# **Tax Litigation before the Spanish Tax Authorities. Special Reference to the Tax Audit Procedure and the Economic-administrative Appeals**

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## **I.- Introduction**

Taxation is an area of contested views all over the world. Nobody agrees as to how much tax a government should collect. However, there seems to be certain consensus regarding the need to collect revenues in order to provide goods and services to the citizens.

Within the Spanish tax system, there are three levels of taxation: local, regional and national. This means that there are also three kinds of tax authorities. Therefore, in Spain taxes are levied by the Central Government, by the Autonomous Communities and by the local authorities.

The Spanish State Tax Agency is responsible for the effective application of the national tax and customs systems (Personal Income Tax, Corporation Income Tax, Income Tax for Non-Residents, Value Added Tax and Special Taxes), and for those resources belonging to other State Public Administrations and the European Union which are entrusted to it for management by law or agreement. All of them constitute the cornerstone of the Spanish tax system.

Spain is divided into seventeen different regions, which are also entitled to audit and collect some taxes, such as transfer tax, inheritance tax and wealth tax. Tax audits are, therefore, carried out by auditors specialized in these taxes and who specifically work for these Autonomous Communities.

Finally, Spanish municipalities also have the power to demand certain taxes. Due to this fact, they have specialized auditors working for them as well. There are two different types of local or municipal taxes:

- Periodic taxes, among them:

- Tax on real estate.
- Tax on business activity.

- Other taxes:

- Tax on erection and installation projects and construction works.
- Tax on increase in urban land value.

Additionally, it should be taken into account that País Vasco and Navarra, due to their unique tax regime, have the power to regulate taxes. They have full or shared regulatory authority in the area of direct taxation, but far more limited authority in the indirect taxation area. They are also empowered to levy, manage, assess, inspect, review and collect taxes, except with respect to import duties and excise taxes on imports.

Finally, the Canary Islands enjoy certain tax benefits so as to compensate them for the disadvantages brought about by insularity and distance from the Spanish mainland and the main goal of which is to attract investments to the Canary Islands.

## **II.- The Spanish tax system**

In Spain there are two tax systems.

Certain taxes are directly liquidated by the Public Administration. For instance, this is the case of the tax on real estate, which is annually levied on owners of real estate or on holders of rights "*in rem*" over real estate.

But essentially the Spanish tax system is a self-assessment system. The taxpayer must file his tax return and determine the amount due, amount which must be paid within the time provided by law.

Voluntary late payment of tax, without a previous request from the tax authorities, prevents the imposition of penalties on the taxpayer. Nevertheless, a surcharge for late payment will be required.

### **III.- Tax verification proceedings. Special reference to the tax audit procedure**

Taxpayers' duties and obligations are subject to control by the corresponding Tax Agency. There are different proceedings.

The most important one is the audit procedure. Its aim is to verify the certifications, elements and values declared by taxpayers in their tax returns and to discover the existence, as the case may be, of undeclared or incorrectly declared taxable items in the tax return.

A tax audit begins either by the direct visit of the tax auditor to the company or "*ex officio*", by a prior notification informing the taxpayer about the nature and scope of the tax audit and asking him to appear before the tax authorities. Normally, the tax audit's scope comprises every tax and period within the statute of limitation. Nevertheless, when auditing VAT, wage taxes and transfer tax, specific tax audits may be carried out.

The tax authorities are allowed to perform different activities in order to adjust the income previously declared by the taxpayer. Specifically, they will:

- a) Verify the elements, certifications and values declared by taxpayers in their tax returns.
- b) Verify the tax allowances and deductions applied.

c) Examine all kinds of evidence related to the tax duty, including the accounting records, in order to find out the ones hidden by taxpayers.

d) Determine the truthfulness and accuracy of tax returns.

During the tax audits, the tax authorities are entitled to analyze and examine all the tax documents, books, main and auxiliary accounting, files, invoices, correspondence with tax significance, computer databases, programs, registrations and data processing files relating to the economic activities carried out by the taxpayer. They are also allowed to inspect goods, assets, business premises... And they may adopt preventive measures, like the sealing, deposit or confiscation of merchandise, files, computers...in order to prevent the disappearance or alteration of the documentation.

Several meetings will take place with the tax auditor in order to discuss or resolve important points for the tax audit. Each meeting will end up with the signing of a public document called "*diligencia*" stating the facts agreed upon with the taxpayer and future requests. The "*diligencia*" will also include the documents or information that the tax auditors have requested from the taxpayer and the date on which these documents and information was supplied to the competent authorities. It is important to note that the "*diligencias*" constitute proof of the facts and dates they include. They are presumed to be correct and can only be rectified by means of proof that an error was made.

Once the tax auditors consider that they have obtained all the relevant information and the documents they need to issue an assessment, a period is

granted for the taxpayer to examine all the documents which are incorporated in the records of the tax audit, submit any additional information it considers necessary or allege what he considers relevant.

Once this period has elapsed, the tax auditors will issue a proposal of assessment called "Acta". There are three kind of "Actas": "Acta" with agreement, "Acta" with conformity and "Acta" with disagreement.

1.- "Acta" with agreement. It may be issued in three cases: a) an assertion about the decisive facts for the correct application of the tax rule turns out to be necessary; b) uncertain legal concepts are discussed and must be applied; or c) estimations, appraisals or measurements of data or elements are to be carried out.

This proposal of assessment will be understood as having been accepted by both the taxpayer and the tax authorities. The assessment and the penalty derived from the "Acta" with agreement may be challenged only through a null and void administrative declaration proceeding.

A 50% reduction will apply to those penalties derived from an "Acta" with agreement.

2.- "Acta" with conformity, which will be issued in case the taxpayer agrees to the assessment proposed by the tax auditors. The conformity refers

only to the facts included in the proposal, not to the application of the law on the basis of these facts.

The assessment will be deemed to be issued and notified to the taxpayer according to the proposal contained in the "Acta" if, after one month after the day following the date of the "Acta", a decision of the Chief Auditor modifying the assessment has not been notified to the taxpayer.

A 30% reduction will apply to those penalties derived from an "Acta" with conformity. An additional 25% reduction will be implemented if the taxpayer pays the penalty on time and does not file an appeal against the penalty's assessment.

3.- "Acta" with disagreement, which will be issued in case the taxpayer does not agree to the facts considered by the tax auditors and to the proposed assessment.

These "Actas" will be accompanied by a supplementary report in which the tax auditors will have to explain in detail the facts taken into account, the laws applicable to the case and the sense in which these laws have been applied to the taxpayer.

After receiving the "Acta" with disagreement and the supplementary report, the taxpayer will have fifteen days to present the grounds of his disagreement.

Finally, once the proposal of assessment, the supplementary report and the taxpayer's allegations have been examined, the Chief Auditor will issue the final assessment.

Normally, the tax audit will end asking the taxpayer to face a tax liability. However, it may also end having the tax authorities to reimburse taxes that should not have been paid or with the acknowledgement of a tax credit against the tax administration.

In general, the tax audit procedure must be concluded within a maximum period of 18 months computed from the notified starting date. Nevertheless, in the event that the tax audit refers to a company filing consolidated tax returns or with an annual turnover equal to or which exceeds the one required to audit accounts, the tax audit procedure must be concluded within a maximum period of 27 months.

Besides the audit procedure there are other tax verification proceedings. Some examples deserve to be mentioned here. For instance, in the data verification procedure, the filed tax returns are normally checked regarding their conformity with the information possessed by the tax authorities. The officer in charge may ask the taxpayer to clarify or justify some of the elements or values included in the return.



There is the limited verification procedure, which aims to verify the facts, decisions, elements, activities, operations and other circumstances that determine the tax obligation. Here, the tax authorities have wider faculties, thus they are not enabled to require the taxpayer to show his accounting books. He may, nevertheless, show them in proof and support of his claims.

And it is also worth mentioning the verification of values procedure, which tries to verify the value of income, products, assets and other elements that determine tax obligations. Parties liable for tax payments may not lodge an appeal or an independent claim against the valuation, but they are allowed to have a contradictory expert valuation carried out or submit any question regarding the valuation in the appeals or claims they may, as appropriate, lodge against the adjustment decision.

In the course of any of the above mentioned procedures, facts may be discovered by the tax authorities which might constitute an administrative contravention. In this case, a separate infringement procedure will be initiated in order to analyse the commission of a tax offence and, if applicable, impose the corresponding penalty, except when this is waived by the taxpayer, in which case it will be carried out jointly. If the procedure is carried out separately, it must be initiated three months after the end of the tax verification procedure and must end within a six-month period. Once the three month period for starting the procedure or the six-month period to end it has elapsed, the procedure for imposing penalties cannot be continued or initiated again.

At this point, it must be said that, depending on the breach committed by the taxpayer, tax offenses can be classified in minor offenses, serious offenses and very serious offenses.

The failure to comply with procedural obligations such as providing the tax identification number in transactions with third parties or the new tax address will be considered as minor offenses.

The failure to meet accounting requirements or submit information to the tax authorities will be considered as serious offenses.

And a very serious offense is the reporting of false information in order to obtain a tax identification number.

#### **IV.- Tax Collection**

Tax collection includes both voluntary and coercive payment of the tax debt.

Voluntary payment takes place within the time provided by law. In the Spanish self-assessment system, this period of time is coincident with the period established for filing the tax return.

If the amount due is not paid within the time provided by law, the coercive collection period will begin. The tax authorities will initiate the enforcement

procedure so as to collect the expired and unpaid debts during the voluntary payment period. The taxpayer will once again have the opportunity to pay his debt, although in a shorter period of time. Once this period has elapsed, without the amount due being paid, the tax authorities will be allowed to execute the guarantees provided by the taxpayer and, failing these, it will proceed to attach the debtor's assets by way of debt collection. The forced execution of attached assets and rights is carried out by means of public auction, direct award or tender. During the executive period, the late-payment interests accrued shall be requested and collected during the enforcement procedure, in addition to the costs incurred by the Tax Agency as a consequence of having to institute this collection procedure.

#### **V.- Economic-administrative appeals**

A taxpayer must jump through many hoops before a matter will proceed to litigation. In general terms, if he is not satisfied with the decision of the Tax Agency, he may lodge an appeal with either the same authority that issued the tax assessment or with the Economic Administrative Courts. Irrespective of the taxpayer's choice, either actions must be filed within one month from the date on which the assessment was notified.

If the taxpayer chooses to appeal to the same authorities that issued the tax assessment and he does not receive an answer from them within one month from the date on which the appeal was filed, it will be considered that a refusal has been issued. The taxpayer may, therefore, file an appeal before the Economic Administrative Court. Nevertheless, he may prefer to wait for an

express decision, which may also be appealed before the Economic Administrative Court.

At this point, it should be noted that the Economic Administrative Courts are administrative bodies, independent from the Tax Agency, that belong to the Ministry of Finance and Public Administration and are thus not part of the judicial system.

There are two kinds of Economic Administrative Courts: the Regional and Local Economic Administrative Courts (*Tribunales Económico-Administrativos Regionales y Locales*) and the Central Economic Administrative Court (*Tribunal Económico-Administrativo Central*).

The Regional and Local Economic Administrative Courts, which are respectively allocated in each autonomous region and in the cities of Ceuta and Melilla, have jurisdiction over the tax assessments issued by the regional bodies of the Spanish state tax authorities or by the regional or local tax authorities. The Central Economic Administrative Court is situated in Madrid and has jurisdiction to decide on appeals issued by the central bodies of the Spanish state tax authorities and on appeals against decisions issued by the Regional and Local Economic Administrative Courts, provided the amount exceeds EUR 150,000 or the taxable base amount exceeds EUR 1,800,000.

In case of amounts exceeding EUR 150,000, the first instance before the Regional and Local Economic Administrative Courts is optional for the taxpayer, who can choose to appeal directly to the Central Economic Administrative Court.

If the economic administrative appeal is rejected, the taxpayer can file a contentious administrative appeal before a Court of Justice within two months from the date on which the economic administrative decision was notified or within six months if one year has passed since the filing of the economic administrative appeal without an express decision from the Economic Administrative Court.

Generally speaking, the National High Court will hear appeals against decisions of the Central Economic Administrative Court and the Courts of Justice will hear appeals against decisions of the Regional and Local Economic Administrative Courts.

An adverse ruling from the National High Court or the Courts of Justice may be appealed before the Supreme Court through the corresponding cassation appeal.